Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap	)	WC Docket No. 05-25
Local Exchange Carriers	)	
	)	
AT&T Corp. Petition for Rulemaking to Reform	)	
Regulation of Incumbent Local Exchange Carrier	)	RM-10593
Rates for Interstate Special Access Services	)	

COMMENTS OF PAETEC HOLDINGS INC.; TDS METROCOM, LLC; U.S. TELEPACIFIC CORP. AND MPOWER COMMUNICATIONS CORP., BOTH D/B/A TELEPACIFIC COMMUNICATIONS; MASERGY COMMUNICATIONS, INC.; AND NEW EDGE NETWORK, INC.

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Dated: January 19, 2010

SUMMARY

(1) Do the Pricing Flexibility Rules Ensure Just and Reasonable Rates?

The pricing flexibility rules have failed to produce just and reasonable rates. The Commission's Phase II pricing flexibility tests incorrectly identify where competition is sufficient to constrain prices because significant record evidence demonstrates the BOCs have been raising prices on basic term lengths in most cases throughout MSAs where they have been granted Phase II pricing flexibility. To address shortcoming with the pricing flexibility rules, the Commission should only permit price cap ILECs, where granted pricing flexibility, to reduce price cap prices.

A. Are the Pricing Flexibility Triggers an Accurate Proxy for Competition that is Sufficient to Constrain Incumbent LEC Prices?

The pricing flexibility triggers, which are based on collocation of competitive carriers in ILEC wire centers, are not an accurate proxy for the kind of sunk investment by competitors sufficient to constrain ILEC special access prices for channel terminations and dedicated transport facilities. Contrary to the Commission's findings in the *Pricing Flexibility Order*, the extent of collocation in a MSA under the pricing flexibility rules is not a reliable of indicator of the level of competition in the special access market needed to deter exclusionary pricing behavior within that MSA. Apart from the shortcomings with the collocation-based trigger itself, the MSA is an inappropriate geographic area in which to grant pricing flexibility. An MSA is far too large an area to grant pricing flexibility because within an MSA, competitive conditions vary widely. The MSA is also deficient because it fails to reflect the perspective of the special access customer and whether the customer can obtain competitive special access services from non-incumbent providers in certain buildings or on certain transport routes within the MSA.

There are a number of other reasons why the pricing flexibility triggers are not an accurate proxy for competition that is sufficient to constrain ILEC prices. The triggers fail to take an ILEC's market power or market concentration into account. The market concentration/share analysis that the NRRI Report performed reveals this fundamental defect in using the triggers. Nor do the triggers recognize the limited impact of potential competition and the non-contestability of the special access market. Moreover, while the triggers distinguish between channel terminations and non-channel terminations, they fail to distinguish among the various channel termination and non-termination product markets. The triggers contain no distinctions based on the capacity of the special access circuit, e.g., DS1, DS3, OC-3, OC-12, etc. and fail to recognize that these circuits are not substitutes for one another. Finally, the triggers fail to take into account lock-up agreements or changing circumstances because an incumbent can forestall the entry of potential competitors by "locking up" large customers by offering them volume and term discounts.

B. What Analytical Framework Should the Commission Apply so that the Pricing Flexibility Rules Ensure Just and Reasonable Rates?

The Commission should apply its traditional market power analysis to determine whether competition exists at a level sufficient to warrant some pricing flexibility for the ILEC. Under Commission precedent, this market power analysis focuses on (a) "identifying the relevant product and geographic markets;" (b) "identifying the market participants" (c) assessing the shares of market participants and the elasticities of supply and demand, and (d) determining whether the incumbent retains market power.

In this analysis the Commission must identify, consistent with sound economic criteria, reasonable product and geographic markets. Consistent with prior analysis of the special access

market the Commission should separately evaluate competition in the channel termination and the transport markets. Similarly, the Commission must separately evaluate product market by capacity level. In addition, because the Commenters propose that the Commission eliminate the forbearance prematurely granted the BOCs for Ethernet and OCn level special access services, the Commission's market-power analysis should separately analyze competition for OCn level services and different capacity levels of Ethernet service.

With respect to the geographic market, the Commission should adopt a building as the appropriate geographic market for analyzing competition in the loop market. Similarly, in the transport market, the Commission should analyze competition on a route-by-route basis. In the alternative, for reasons of administrability, the Commission might aggregate the geographic markets for loops to the wire center level using sufficiently stringent criteria but not an MSA.

Further, the Commission should revisit the broadband forbearance relief granted to AT&T, Qwest and Verizon on a national basis and apply the discrete product and geographic market analysis proposed in these comments. The Commission is not tied to these decisions and can revisit them and even received an invitation from the D.C. Circuit to do so in the course of its comprehensive review of special access markets.

The Commission's market power analysis should consider supply elasticity in the special access market, which refers both to the ability of suppliers in a given market to increase the quantity of service supplied in response to an increase in price as well as entry barriers facing new entrants. The next step in the market power analysis is to examine demand elasticity which refers to the ability of customers to switch to another provider in response to anti-competitive practices by the dominant carrier. Although not indispensable to a market power analysis, market share remains an important component of the Commission's market power analysis because it

examines the level of concentration in a market, and "concentration in the relevant markets is one indicator" of the potential for anti-competitive conditions.

In conducting its market share analysis, the Commission should require the presence of at least three or ideally four facilities based providers before granting pricing flexibility in order to avoid the dangers of undue concentration, especially in light of the supply and demand elasticities that reflect the difficulties competitors have in adding new supply and the inability of customers to easily switch suppliers. The reliance on three to four competitors is consistent with the DOJ and FTC merger guidelines and recognizes that consumers can be significantly harmed when there are fewer than three or four providers in a highly concentrated market and receive substantial benefits when the number of strong competitors rises from two to three or from three to four.

In order to validate the methodology proposed in these comments, the Commission should seek street address information for buildings actually connected to lit fiber owned by a service provider. The data collection should, however, be limited to lit buildings, because the analysis to determine whether the cost/time/investment for constructing laterals to existing fiber networks is not easily administrable.

The analytic framework proposed in these comments, including the route-by-route transport market analysis and the building-by-building analysis for the loop market, is reasonable and administrable. The Commission and the DOJ have previously obtained building-by-building data ILECs and CLECs. The Commission has the authority to issue or use Form 477 reporting. to devise a data collection effort necessary to conduct the analysis proposed herein.

(2) Do The Price Cap Rules Ensure Just And Reasonable Rates?

The Commission's price cap rules do not ensure the just and reasonable rates that Section 201(b) of the Act requires. When the price cap regime was implemented, the Commission made clear that observed returns remain the litmus test for determining whether the specific price cap rules are working to protect consumers from unjust and unreasonable rates. It recognized that a future comprehensive review of the price cap mechanism would focus prominently on the ILEC's costs and profits.

Price cap rates are unreasonable because, among other things, they do not reflect cost decreases resulting from increased demand or efficiencies in providing special access services. In this connection, the price cap regime does not have an X-factor that requires price cap ILECs to reduce prices annually on a going-forward basis to reflect lower costs in provisioning special access services based on productivity gains. In addition, the price cap regime fail to require BOCs to share incredible gains or excessive earnings in provisioning special access services with the ratepayers.

Furthermore, the bloated ARMIS rates-of-return the BOCs are enjoying demonstrates that price cap rates are excessive. The BOCs' criticisms of ARMIS can be rejected readily, as the record demonstrates. Even the 2009 NRRI study — after adjusting the BOCs' earnings to address the BOCs' claim that the Commission's separation freeze renders ARMIS rates-of-return unreliable – found that the BOCs have "raised prices above average cost" and earnings above 11.25%. The fact that this rate-of-return is outdated and should actually be in the range of eight percent making the BOCs' earnings and prices even more excessive. If anything, the BOCs' average ARMIS rates-of-return are likely significantly understated, as ETI has shown, because the BOCs included capital expenditures made for the purpose of offering unregulated broadband

and video services, such as Verizon's FiOS and AT&T's Project Lightspeed, within the "regulated services" category. While the BOCs have argued that the Commission should not rely on ARMIS rates-of-return data, they have failed to provide any evidence demonstrating what their special access rates-of-return are under some other measure that they deem more appropriate.

Moreover, the fact that price cap rates exceed forward-looking cost-based UNE rates, rates offered by competitors, and rate-of-return NECA rates provides further evidence that special access rates are unreasonable. Apart from the fact that price cap rates are excessive on an overall basis, even if price cap rates were reasonable on average, the basket structure used to set price rates is unreasonable because it permits price increases in non-competitive areas and decreases in competitive areas.

To ensure that price cap rates are just and reasonable, the Commenters recommend that the Commission take the following actions. The Commission should first reinitialize special access prices based on the latest demand and forward-looking cost inputs. Once special access rates are reinitialized, the Commission should include all special access rates under a modified price cap regulatory framework. The permanent features of this regulatory framework should include a productivity-based X-factor, revenue sharing, as well as the service baskets and categories previously proposed.

(3) Do the Commission's Price Cap and Pricing Flexibility Rules Ensure that the Terms and Conditions in Special Access Tariffs and Contracts are Just and Reasonable?

The Commission's price cap and pricing-flexibility rules have not prevented the BOCs from imposing onerous and unreasonable terms and conditions on the purchase of special access services. The BOCs have twisted the application of volume and term commitments to turn them

into "lock-ups" in many cases, and they have also leveraged their market power to impose a number of other anticompetitive terms and conditions. These "lock-up" tactics proceed from standard rates that are so high that every purchaser is effectively compelled to purchase in substantial volumes and/or for longer terms to be able to justify the purchase at all. Because there is limited competition, at best, on many routes and to many buildings, customers are left with little choice but to "buy in bulk" and accept such terms. Indeed, such exclusionary deals are contrary to established antitrust principles that prohibit anticompetitive bundling or tying -- not only compelling customers to purchase products that they might not otherwise need or want (just to obtain better rates on the monopoly products), but also serving to exclude competitors who cannot offer as wide a range of products.

The Commission should therefore adopt general prohibitions against tying arrangements and cross-subsidization, while also specifically prohibiting the BOCs from requiring a customer: (1) to purchase a specified quantity of other services to obtain discounts or credits on channel terminations; (2) to ensure that channel terminations represent only a limited percentage of the customer's total spend; (3) to satisfy any ratios that limit the amount of non-special access services a customer can purchase to receive discounts or credits; (4) to purchase products in multiple geographic markets to obtain discounts or credits; (5) to refrain from any purchases of UNEs or other specified services (or the commingling of such services with special access services); and (6) to migrate a certain percentage of total spend or quantity of circuits from a competitor as a condition to obtaining discounts or credits.

(4) Recommended Additional Question: "Is there any need for interim relief?"

In reaching its final determinations, the Commission should adopt and issue new measures on a rolling basis rather than sweeping all such final determinations into a single longer-term package of reforms. Moreover, there are several interim steps that the Commission can and should take to address the most obvious shortcomings of its price cap and pricing flexibility rules in advance of making any final determinations in this docket, particularly to ensure that its continuing efforts here are not eclipsed by expirations of existing contract tariffs and withdrawals or grandfathering of special access purchase plans in the special access market.

First, the Commission should "freeze" or "cap" ILEC special access rates at their current levels on an interim basis. Such a cap would allow a customer of the ILEC to continue, until final rules are issued in this docket, to purchase interstate special access services at a rate no higher than that applicable to the customer's special access purchases as of the date the cap takes effect. Such an interim "freeze" or "cap" represents a reasonable means of maintaining the *status quo* and ensuring that the ILECs' ability to increase rates will not outpace the Commission's investigation.

Second, the Commission should take immediate action to "roll back" any standard pricing flexibility rates that are higher than their respective price cap rate counterparts; put another way, the Commission should impose on an interim basis for the pendency of this proceeding a "secondary cap" that would ensure that the standard "rack" rates in pricing flexibility areas do not exceed price cap levels.

Third, the Commission should cease granting any new applications for pricing flexibility until it has adopted a new framework for such grants. The shortcomings of the current standard for such grants are obvious on the record of this proceeding, and there is little reason for the

Commission to perpetuate that system even as it considers how to re-work it. Alternatively, if it will continue to consider such applications, the Commission should grant any application on the condition that the recipient will not use pricing flexibility to *increase* interstate special access service rates above those in effect under the previously applicable price cap regime.

As a fourth measure of interim relief, the Commission should take up once again the option it first considered in the notice of proposed rulemaking initiating WC Docket No. 05-25 -- the imposition of a 5.3% productivity factor to reflect productivity gains that characterize the telecommunications industry. Indeed, if anything, a 5.3% X-factor may be too low in light of the substantial investment that many ILECs have made in last mile facilities (e.g. hybrid loops, FTTC, FTTH) in connection with broadband deployment, but it would at least represent a reasonable interim step while the Commission considers the matter further.

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FCC Decisions

1997 Price Cap Review Order	*Price Cap Performance Review for Local Exchange Carriers*, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642 (1997) (subsequent history omitted)
Access Charge Reform Order	*Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, First Report and Order, 12 FCC Rcd 15982 (1997) (subsequent history omitted).
AT&T Broadband Forbearance Order	*Petition of AT&T Inc. for Forbearance Under 47 USC Section 160(c) from Title II and Computer Inquiry Rules with Respect to Its Broadband Services*, 22 FCC Rcd 18705 (2007) (subsequent history omitted)
CALLS Order	*Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 99-249, 96-45, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000) (subsequent history omitted)
Comsat Non-Dominance Order	*Petition Pursuant to Section 10(c) of the Communications Act of 1934, as Amended, for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier*, Order and Notice of Proposed Rulemaking, 13 FCC Rcd 14083 (1998)
Echostar	*Application of EchoStar Communications Corporation, General Motors Corporation, and Hughes Electronics Corporation*, CS Docket No. 01-348, Hearing Designation Order, 17 FCC Rcd 20559, 20605-06 (2002)
LEC Price Cap Order	*Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990) (subsequent history omitted)

Pricing Flexibility Order	*Access Charge Reform*, CC Docket No. 96-262, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999) (subsequent history omitted)
SBC/AT&T Merger Order	*SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Doc. No. 05-65, Memorandum Opinion and Order, 20 FCC Rcd 18290 (rel. Nov. 17, 2005)
TRO	*Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003), *corrected by* Errata, 18 FCC Rcd 19020 (2003), *aff'd in part, remanded in part, vacated in part, United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004), *cert. denied sub nom. Nat'l Ass'n Regulatory Util. Comm'rs v. United States Telecom Ass'n*, 125 S. Ct. 313 (2004)
TRRO or *Triennial Review Remand Order*	*Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd 2533 (2005), *aff'd*, *Covad Commc'ns Co. v. FCC*, 450 F.3d 528 (D.C. Cir. 2006)
Special Access NPRM	*Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd 1994, FCC 05-18 (rel. Jan. 31, 2005).

Comments and *Ex Partes* Filed

360 *et al.* 8/15/07 Comments	360Networks (USA), Inc., ATX Communications, Inc., Bridgecom International, Inc., Broadview Networks, Inc., Cavalier Telephone, LLC, Deltacom, Inc., Integra Telecom, Inc., Lightyear Network Solutions, LLC, McLeodUSA Telecommunications Services, Inc., Penn Telecom, Inc., RCN Telecom Services, Inc., SAVVIS, INC., and U.S. TelePacific Corp. d/b/a TelePacific Communications, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
Ad Hoc 6/13/05 Comments	Comments of the Ad Hoc Telecommunications Users Committee, WC Doc. No. 05-25 (filed June 13, 2005)
Ad Hoc 7/29/05 Reply Comments	Reply Comments of the Ad Hoc Telecommunications Users Committee, WC Doc. No. 05-25 (filed July 29, 2005)
Ad Hoc 8/8/07 Comments	Comments of the Ad Hoc Telecommunications Users Committee, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
ATX *et al.* 6/13/05 Comments	Comments of ATX Communications Services, Inc., BridgeCom International, Inc., Broadview Networks, Inc., Pac-West Telecom, Inc., US LEC Corp, and U.S. TelePacific Corp. d/b/a TelePacific Communications, WC Doc. No. 05-25 (filed June 13, 2005)
ATX *et al.* 7/29/05 Reply Comments	Reply Comments of ATX Communications Services, Inc., BridgeCom International, Inc., Broadview Networks, Inc., Pac-West Telecomm, Inc., US LEC Corp, and U.S. TelePacific Corp. d/b/a TelePacific Communications, WC Doc. No. 05-25 (filed July 29, 2005)
ATX *et al.* 8/8/07 Comments	ATX Communications, Inc., Bridgecom International, Inc., Broadview Networks, Inc., Cavalier Telephone, LLC, Deltacom, Inc., Integra Telecom, Inc., Lightyear Network Solutions, LLC, McLeodUSA Telecommunications Services, Inc., Penn Telecom, Inc., RCN Telecom Services, Inc., SAVVIS, INC., and U.S. TelePacific Corp. d/b/a

	TelePacific Communications, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
COMPTEL *et al.* 6/13/05 Comments	Comments of CompTel/ALTS, Global Crossing North America, Inc., and NuVox Communications, WC Doc. No. 05-25 (filed June 13, 2005)
DOJ 1/4/09 *Ex Parte*, GN Doc. No. 09-51	*Ex parte* Submission of the United States Department of Justice, GN Docket No. 09-51 (Jan. 4, 2010)
ETI Report	Letter from Colleen Boothby, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Sec'y, Federal Communications Commission, RM-10593, Att. (Economics and Technology, Inc., Competition in Access Markets: Reality or Illusion – A Proposal for Regulating Uncertain Markets) (filed Aug. 26, 2004).
GAO Report	U.S. GENERAL ACCOUNTABILITY OFFICE, REPORT TO THE TO THE CHAIRMAN., COMMITTEE ON GOVERNMENT REFORM, HOUSE OF REPRESENTATIVES - TELECOMMUNICATIONS, "FCC NEEDS TO IMPROVE ITS ABILITY TO MONITOR AND DETERMINE THE EXTENT OF COMPETITION IN DEDICATED ACCESS SERVICES (November 2006)
Global Crossing 8/8/07 Comments	Comments of Global Crossing North America, Inc., WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
NRRI Report	Nat'l Regulatory Research Inst., "Competitive Issues in Special Access Markets, Revised Edition," No. 09- 02, Jan. 21, 2009. *available at* http://nrri.org/pubs/telecommunications/NRRI_spcl_access_mkts_jan09-02.pdf.
Sprint 6/13/05 Comments	Comments of Sprint Corporation, WC Doc. No. 05-25 (filed June 13, 2005)
Sprint 8/8/07 Comments	Comments of Sprint Nextel Corporation, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)
T-Mobile 6/13/05 Comments	Comments of T-Mobile USA, Inc., WC Doc. No.

	05-25 (filed June 13, 2005)
TWTC 7/9/09 *Ex Parte*	Letter from Thomas Jones, Counsel to tw telecom inc., to Marlene H. Dortch, Secretary FCC, WC Docket No. 05-25 (filed July 9, 2009)
WilTel 7/29/05 Reply Comments	Reply Comments of WilTel Communications, LLC, WC Doc. No. 05-25 (filed July 29, 2005);
XO *et al.* 8/8/07 Comments	Comments of XO Communications, LLC, Covad Communications Group, Inc., and NuVox Communications, WC Doc. No. 05-25, RM-10593 (filed Aug. 8, 2007)

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PAETEC HOLDINGS INC.; TDS METROCOM, LLC; U.S. TELEPACIFIC CORP., D/B/A TELEPACIFIC COMMUNICATIONS AND MPOWER COMMUNICATIONS CORP., D/B/A TELEPACIFIC COMMUNICATIONS; MASERGY COMMUNICATIONS, INC.; AND NEW EDGE NETWORK, INC.

PAETEC Holdings Inc., parent company of PAETEC Communications, Inc., McLeodUSA Telecommunications Services, Inc. and various US LEC entities, all of which do business as PAETEC ("PAETEC"); TDS Metrocom LLC; U.S. TelePacific Corp. and Mpower Communications Corp., both d/b/a TelePacific Communications; Masergy Communications, Inc.; and New Edge Network, Inc. (collectively "Commenters"), submit these comments in response to the Commission's request that parties comment on the analytical framework necessary to resolve issues in the *Special Access NPRM*.[1]

[1] *Parties Asked to Comment on Analytical Framework Necessary to Resolve Issues in the Special Access NPRM*, Public Notice, WC Docket No. 05-25, RM-10593, DA 09-2388 (rel. Nov. 5, 2009).

I. ANSWERS TO THE COMMISSION'S QUESTIONS

(1) Do the Pricing Flexibility Rules Ensure Just and Reasonable Rates?

The pricing flexibility rules have failed to produce just and reasonable rates. The Commission has long recognized that a robust competitive market produces just and reasonable rates and in the absence of a competitive market, rates established pursuant to rate-of-return regulation are considered just and reasonable. In the *Special Access NPRM*, the Commission recognizes that "in assessing the state of competition in a market (regardless of whether a full market power analysis or a less burdensome analysis is performed)," even "if a market is (or is presumed to be) competitive *ex ante*, the level of competition can be assessed by determining whether there have been *substantial* and *sustained* price increases."[2] In determining what constitutes a substantial price increase, the Commission has stated that "a substantial price increase need not be a large increase" but can be a "small but significant non-transitory price increase in the relevant product market."[3]

Based on this standard, the record demonstrates that the special access market is not competitive and has not produced just and reasonable rates because the BOCs, which are price cap LECs, have: (a) substantially increased interstate special access rates on basic contract term lengths in most cases, (b) done so in the face of declining costs,[4] and (c) sustained those rate increases over time in the MSAs for which the LECs have received Phase II pricing flexibility.

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[2] *Special Access NPRM*, ¶ 73 (emphasis in original, citations omitted).

[3] *Id*. n.188 (internal quotes and citation omitted).

[4] The fact that there has been a steady and substantial reduction in the BOCs' costs of providing service over a period of years, as discussed below, further demonstrates the level of competition in the market is insufficient to overcome the BOCs' market power and prevent them from maintaining or increasing their rates. *See* Ad Hoc 6/13/05 Comments, at 25.

Numerous comments[5] and declarations[6] filed along with the ETI Report,[7] GAO Report[8] and the NRRI Report[9] released in 2009 have come to this conclusion.[10] The latest revealing analysis includes the pricing charts TWTC provided to the Commission, demonstrating the "trend" of "incumbents [to] increase prices when freed from regulation."[11]

Moreover, the tables provided below illustrate that the record is not outdated. As shown in Table 1 below, Verizon's current special access DS1 loop recurring rates over the contract term lengths referenced are approximately 15-30% higher where it has obtained special access pricing flexibility. Table 2 reveals that Qwest's current special access DS1 loop rates are approximately 26-47% higher where it has obtained special access pricing flexibility. A similar analysis cannot be performed with respect to AT&T because it agreed pursuant to the AT&T/BellSouth merger condition to reduce price flex rates that are higher than price cap rates for an interim period.[12] Once these merger conditions sunset on June 30, 2010, however, the rates AT&T reduced are expected to shoot upwards again.[13]

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[5] *See, e.g.*, ATX *et al.* 6/13/05 Comments, at 10-13; ATX *et al.* 8/8/07 Comments, at 5-7 & 10-11, Attachment 4; TWTC 7/9/09 *Ex Parte*, at 6-7; XO *et al.* 8/8/07 Comments, at 11 & 15.

[6] *See, e.g.*, AD Hoc 8/8/07 Comments, Declaration of Susan Gately, ¶ 17-19, Exhibits 1-3; Global Crossing 8/8/07 Comments, Declaration of Janet S. Fisher ¶ 5-8; Sprint 8/8/07 Comments, Declaration of Bridger Mitchell, ¶¶ 48-58, Exhibit 1; COMPTEL *et al.* 6/13/05 Comments, Declaration of Janet S. Fisher ¶¶ 7-8 & Tables 1-6; Ad Hoc 6/13/05 Comments, Declaration of M. Joseph Stith, ¶¶ 17-18 and supporting rate comparisons.

[7] ETI Report, at 35-38.

[8] GAO Report, at 13 & 28 (concluded that prices for special access services in MSAs with Phase II pricing flexibility are on average higher than prices elsewhere).

[9] *See, e.g.*, NRRI Report, at 66 (concluding that overall the evidence indicates that "sellers are using market power in phase II areas to raise prices to their large corporate customers").

[10] This conclusion should not be interpreted to mean that the ILECs' price cap rates are somehow just and reasonable. To the contrary, as described below in Section I.(2), they are not.

[11] TWTC 7/9/09 *Ex Parte* at 6.

[12] *See AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, WC Doc. No. 06-74, Memorandum Opinion and Order, 22 FCC Rcd 5662 Appendix F, Condition 6 (rel.

Table 1
Comparison of Verizon's FCC No. 1 DS1 Channel Termination Price Cap Rates With Phase II Pricing Flexibility Rates[14]

	Month to Month Rates (No Term)			1 Year Term Monthly Rates			2 Year Term Monthly Rates		
Rate Zones	Price Cap[15]	Price Flex[16]	% Increase	Price Cap[17]	Price Flex	% Increase	Price Cap[18]	Price Flex[19]	% Increase
1	$197.00	$225.63	14.53%	Same as MTM	Same as MTM	Same as MTM	$167.45	$191.79	14.53%
2	$218.16	$283.55	29.97%	Same as MTM	Same as MTM	Same as MTM	$185.44	$241.02	29.97%
3	$231.49	$293.06	26.60%	Same as MTM	Same as MTM	Same as MTM	$196.77	$249.10	26.60%

Mar 26, 2007); Order on Reconsideration, 22 FCC Rcd 6285, Appendix (rel. Mar 26, 2007) (requiring that AT&T set rates for DS1 and DS3 special access services in areas subject to phase II pricing flexibility no higher than price cap rates).

[13] TWTC 7/9/09 *Ex Parte*, at 6 & n.15; *see, e.g.*, Ameritech Operating Companies, FCC No. 2, at Section 21.5.2.7.1(A)(1) (original page 790.1); *see also* Exhibit 1 (referencing AT&T rates that go into effect after June 30, 2010 and providing tariff pages). The BOCs are not the only local carriers that have increased their special access rates. Over the course of three separately filed rate increases in one year alone (2008), Embarq increased the pricing flexibility rates for its DS1 channel termination in Nevada for 0-3 miles and over three miles from $97.50 and $111.00 to $113.00 and 132.00, respectively. This is an approximate 16% and 31% respective increase for these last mile facilities. See Embarq — FCC No. 1, Section 22.5.14(A)(4)(a) at 22-364 (Transmittal Nos. 48, 55 and 64).

[14] Verizon's price cap and pricing flexibility rates in Massachusetts under its FCC No. 11 tariff are the same as those in this table. *See* Verizon — FCC No. 11 Section 31.7.9.(A)(1)(a) at 31-122 and Section 30.7.9(A)(1)(a) at 30-55.; *see also* Verizon — FCC No. 11 Section 7.4.10(B)(1)(b) at 7-274 (for discounts that apply to term commitments).

[15] *See* Verizon — FCC No. 1 Section 7.5.9(A)(1)(a) at 7-250 (Rate Zones 1-3).

[16] *See* Verizon — FCC No. 1 Section 7.5.9(A)(1)(a) at 7-250 (Price Band 4-6). It is our understanding that pricing zone rates apply in Verizon's price cap areas, whereas price band rates apply in pricing flexibility areas. Under Verizon's tariff, there are three pricing zones 1-3 and three pricing bands 4-6. In this comparison, we compare price zone 1 with price band 4, price zone 2 with price zone 5, and price zone 3 to price band 6.

[17] Verizon offers no discounts to 1 year terms.

[18] *See* Verizon — FCC No. 1 Section 7.5.16(A) at 7-264 (Rate Zone 1-3).

[19] *See* Verizon — FCC No. 1 Section 7.5.16(A) at 7-264 (Price Band 4-6).

Table 2									
Comparison of Qwest's DS1 Channel Termination Plan Price Cap Rates With Phase II Pricing Flexibility Rates									
	Month to Month Rates (No Term)			**1 Year Term Monthly Rates**			**2 Year Term Monthly Rates**		
Rate Zones	Price Cap[20]	Price Flex[21]	% Increase	Price Cap	Price Flex	% Increase	Price Cap	Price Flex	% Increase
1	$112.30	$165.00	46.93%	$108.95	$156.00	43.18%	$106.70	$140.00	31.21%
2	$120.00	$175.00	45.83%	$116.40	$166.00	42.61%	$114.00	$150.00	31.58%
3	$132.25	$185.00	39.89%	$128.30	$175.00	36.40%	$125.60	$158.00	25.80%

Even assuming, *arguendo*, that special access customers negotiate discounts that reduce "rack rates," the discounts would need to be in the range of 15-47% to bring effective pricing flexibility rates on par with price cap rates. As discussed in Section I.(4), it is not clear that such discounts are sustainable for the long term. Moreover, the BOCs breeze past the level of sophistication necessary on the part of the customer to obtain such discounts — the hoops that one must jump through in the form of overlapping discount plans, credit plans, and contract tariffs to obtain a relatively lower effective rate for special access are staggering.

As explained further herein, only customers that have immersed themselves in the complicated negotiations and navigation of ILEC special access tariffs and who have specialists dedicated to managing special access service purchases have a realistic hope of achieving a more reasonable effective rate. For example, to obtain an effective rate that it could live with, one of the Commenters has established with just a single ILEC three separate pricing flexibility contract tariffs, two generally available tariff credit plans, and two other agreements that in part provide credits on special access services. In another case, it took this same Commenter nearly three years to negotiate a pricing flexibility agreement with a different ILEC. Moreover, while the

[20] *See* Qwest — FCC No. 1 Section 7.11.4.A.1., at 7-347 (also contains the 1 and 2 year term price cap rates).

[21] *See* Qwest — FCC No. 1 Section 17.2.11.A.1, at 17-91 (also contains the 1 and 2 year term Phase II pricing flexibility rates).

Commenters may qualify as "purchasing experts" (largely because they were required to do so in light of their dependence on ILEC last mile facilities as discussed further herein), and while they may have been able to cobble together such purchase plans to date, they remain in many respects at the mercy of the BOCs who can eliminate, grandfather, or otherwise modify many of these plans in the near- to mid-term.

Moreover, even if a large purchaser is sophisticated enough to negotiate deeper discounts, ILECs routinely impose anticompetitive terms and conditions that bind a carrier to use special access services to exclusion of other competitors or lower cost network element alternatives offered by the ILEC within its entire region (effectively requiring a CLEC to forbear from using UNEs within that ILEC's territory). In other words, accessing meaningful discounts requires the competitive carrier to give up rights that a competitive carrier would not choose to give but for the fact that there is no competitive market for special access services.

The Commenters submit that it is not good policy to excuse a carrier from regulation simply because some subset of customers (even if they represent a sizeable portion of total revenues) have some ability to protect themselves. , or simply because a subset of competitive carriers, perhaps due to the specific markets in which they operate, are willing to forego use of lower cost UNEs or other network elements throughout an ILEC's entire region since it does not have the same effect on their business plan as it does other competitive carriers. A small or mid-sized business that operates in a pricing flexibility area, for example, will not have the scale or expertise to navigate the tariff options to obtain lower rates, and it likely cannot justify signing a 5-year term agreement for a few DS1 services just to achieve the same rate that it would have received if its offices were located in a price cap rate area. If the Commission examines the success of its pricing flexibility regime for all customers, including the SME that buys limited

circuits on a one-or two-year term plan, the evidence shows the regime has failed to constrain price increases.

Likewise, a nationwide competitive LEC that loses access to UNE T1 loops due to a grant of UNE forbearance or a new wire center designation will either have to accept the special access rack rate or take a relatively insignificant discount if the BOC requires that the CLEC forego use of UNEs in exchange for a meaningful discount since the overall cost of foregoing UNEs throughout the BOC's entire region would cost significantly more than the savings the discount would provide in the wire center affected by the regulatory change.

In any event, while Commission contemplated that there may be some rate increases, it did not believe that would be the norm. The Commission recognized that (a) "the regulatory relief we grant upon a Phase II showing may enable incumbent LECs to increase access rates for some customers"[22] and (b) relieving special access service from price cap regulation in qualifying MSAs could "lead to higher rates for access to some parts of an MSA that lack a competitive alternative.…"[23] The price increases that BOCs have been able to implement (because of the absence of competitive alternatives) have not, however, been confined to "some parts of an MSA" or 'some customers," as the Commission anticipated. Rather, as discussed, price increases have occurred throughout MSAs that have qualified for Phase II pricing flexibility.

History shows that the Commission's belief that Phase II relief was justified because its price cap rules may have required ILECs to price access services below cost in certain areas was

[22] *Pricing Flexibility Order*, ¶ 155.

[23] *Id*.¶ 142.

incorrect.[24] If this unsupported 1999 speculation about below-cost pricing was ever valid, it since has been invalidated by the astronomical ARMIS rates-of-return that BOCs are earning on special access service, as the record reveals. There is no realistic possibility that BOCs are providing special access service below cost, especially since the BOCs' pricing flexibility rates are higher than NECA rates as shown below. Thus, the Commission's concern about the theoretical possibility of below-cost pricing does not now, if it ever did, justify a regulatory scheme that permits widespread price increases of the type that Phase II pricing flexibility has enabled BOCs to have implement.

Apart from the fact that Phase II pricing rates have been generally increasing, as noted above, the rate levels are too high and unreasonable based on the rate comparisons in the table below. The table compares the BOCs' DS1 Phase II pricing flexibility monthly one-year term rates with the rate for the same services provided pursuant to the NECA Tariff.[25] The table shows that the BOC pricing flexibility rates are much higher the NECA rates.

Table 3

BOC	Price Flex. Rates	Percent Above NECA Rate of $218.33
Qwest	$395.00	80.92%
AT&T-CA (until 6/30/10)	$274.50	25.73%
AT&T-CA (after 6/30/10)	$317.50	45.42%
AT&T- MI (until 6/30/10)	$511.00	134.05%
AT&T- MI (after 6/30/10)	$534.00	144.58%
AT&T- TX (until 6/30/10)	$414.00	89.62%
AT&T TX (after 6/30/10)	$450.00	106.11%
AT&T-FL (until 6/30/10)	$403.00	84.58%
AT&T-FL (after 6/30/10)	$433.00	98.32%

[24] *Id.*

[25] Pricing reflects the total of 1 Channel Termination, 1 Channel Mileage Fixed, 10 Channel Mileage (per mile). *See* Exhibit 1 attached hereto for further details concerning this Table 3 comparison.

Verizon-MA	$554.33	153.90%
Verizon-PA	$554.33	153.90%

This comparison is particularly striking because companies that participate in the NECA tariff are rate-of-return companies that typically serve small populations thinly spread over relatively large geographic areas.[26] Covering these low-density areas requires extensive cable and wire facilities and added electronics that drives up the cost per subscriber to deliver DS1 and other high capacity services to rural customers.[27] Unlike the BOCs, NECA members "do not enjoy the economies of scale afforded their large, no-rural counterparts that operate in urban areas and serve many thousands of access lines per square mile."[28] Therefore, one would expect that NECA rates should be *higher than* the BOCs' rates in urban areas where the BOCs have received pricing flexibility. The fact that the BOCs' pricing flexibility rates exceed the rates offered by rate-of-return carriers demonstrates that the BOCs' rates are excessive and generating unreasonable profits.

There is no justification, in any event, for a regulatory framework governing special access that permits price cap ILECs to *increase* prices based on a cursory showing of competition. A truly competitive market should pressure prices downwards, not upwards. At the very least a competitive market would not permit price cap ILECs have no reason to raise prices in response to competition, except for the anticompetitive tactic of raising prices where there is no competition to offset predatory pricing in other areas. The fact that BOCs have typically raised prices in areas subject to Phase II pricing flexibility, as discussed above, undermines the conclusion that sufficient competition existed in those areas to act as a market

[26] NECA Trends 2009, A report on rural telecom technology, at 4, *available at* https://www.neca.org/cms400min/NECA_Templates/Studies_and_Surveys.aspx.

[27] *Id*.

[28] *Id*.

check on the ILECs and protect customers. Allowing price cap ILECs to raise prices in response to competition has no theoretical basis and invites abuse.

If the tests accurately identified where competition could replace regulation as the guarantor of reasonable prices, BOCs would have by and large reduced or maintained prices on basic contract term lengths where granted Phase II pricing flexibility. Rather, record evidence demonstrates the antithesis of this desired result. Even if prices have remained the same in some cases, customers have been harmed because service in those areas has not been subject to any X-Factor reductions, as further discussed below, which would have been permitted customers to obtain the benefits of increased technological efficiencies. Phase II pricing flexibility, especially after the expiration of the CALLS plan, has been a huge windfall for price cap ILECs.

To address the failure of the pricing flexibility rules to result in just and reasonable special access rates, the Commission should only permit ILECs, where granted pricing flexibility, to *reduce* price cap prices. The fact that BOCs have, as demonstrated above, been raising prices on basic contract term lengths in most cases throughout MSAs where they have been granted Phase II pricing flexibility, shows that the Commission's Phase II pricing flexibility tests incorrectly identify where competition is sufficient to constrain prices.

A. Are the Pricing Flexibility Triggers an Accurate Proxy for Competition that is Sufficient to Constrain Incumbent LEC Prices?

The pricing flexibility triggers, which are based on collocation of competitive carriers in ILEC wire centers, are not an accurate proxy for the kind of sunk investment by competitors sufficient to constrain ILEC special access prices for channel terminations and dedicated transport facilities. By way of background, the Commission adopted the pricing flexibility triggers to ensure that its interstate access charge regulations did not unduly interfere with

competition developing in special access markets.[29] The triggers were designed to measure whether competitors had made irreversible, sunk investment in collocation and transport facilities.[30] If a price cap carrier satisfied the triggers, it could enter into individualized contracts with its special access customers.

A price cap carrier could obtain pricing flexibility in two separate phases, each on a Metropolitan Statistical Area (MSA) basis. Under Phase I relief, a price cap carrier may offer volume and term discounts and contract tariffs for interstate special access services unconstrained by the Commission's Part 61 rate level rules and Part 69 rate structure rules.[31] Under Phase I, the price cap carrier must, however, continue to offer its generally available, price cap constrained (*i.e.*, subject to both Part 61 and Part 69) tariff rates for these services.[32] Under Phase II relief, in contrast, a price cap carrier may file individualized special access contract tariffs, subject only to continuing to make available generalized special access tariff offerings, [33]

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[29] *Pricing Flexibility Order*, ¶ 1.

[30] *Id.* ¶¶ 77-83.

[31] For a price cap carrier to obtain Phase I relief for interstate special access services other than channel terminations between its end office and an end user's customer premises, the price cap carrier must demonstrate that unaffiliated competitors have collocated in at least 15 percent of the LEC's wire centers within an MSA or collocated in wire centers accounting for 30 percent of the LEC's revenues from these services within the MSA. For a price cap carrier to obtain Phase I pricing flexibility for channel terminations between its end office and a customer premises, the price cap carrier must demonstrate that unaffiliated competitors have collocated in at least 50 percent of its wire centers within an MSA or collocated in wire centers accounting for 65 percent of the LEC's revenues from these services within the MSA. 47 C.F.R. §§ 69.709, 69.711; *Pricing Flexibility Order*, ¶¶ 24, 93-99; *Special Access NPRM*, n.56.

[32] *Pricing Flexibility Order*, ¶ 24.

[33] For a price cap LEC to obtain Phase II relief for special access services other than channel terminations to end users, the trigger thresholds are unaffiliated collocation in 50 percent of the price cap carrier's wire centers or in wire centers accounting for 65 percent of the price cap carrier's revenues from these services within the MSA. For channel terminations to end users, the Phase II thresholds are unaffiliated collocation in 65 percent of the price cap carrier's

with neither the contract tariffs nor the general offerings being constrained by Part 61 or Part 69 of the Commission's rules.[34]

The Commission explained that it adopted the pricing flexibility rules to provide regulatory relief for "special access services coincident with the development of competition for these services."[35] It found that the pricing flexibility "triggers would accurately predict the existence of competitive pressures that would discipline interstate special access rates."[36] It explained that "[t]he pricing flexibility framework . . . is designed to grant greater flexibility to price cap LECs as competition develops, while ensuring that: (1) price cap LECs do not use pricing flexibility to deter efficient entry or engage in exclusionary pricing behavior; and (2) price cap LECs do not increase rates to unreasonable levels for customers that lack competitive alternatives."[37]

In evaluating exclusionary pricing behavior, the Commission stated that the presence of facilities-based competition with significant sunk investment makes exclusionary pricing behavior costly and highly unlikely to succeed. It assumed that collocation by competitors in incumbent LEC wire centers was a reliable indication of sunk investment by competitors.[38] According to the United States Government Accountability Office ("GAO"), by 2006, the BOCs had obtained Phase II flexibility for both channel terminations and channel mileage in 112 Metropolitan

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wire centers or in wire centers accounting for 85 percent of the price cap carrier's revenues for these services. 47 C.F.R. §§ 69.709, 69.711; *Pricing Flexibility Order*, ¶¶ 25, 146-52.

[34] *Pricing Flexibility Order*, ¶¶ 25, 153-55.

[35] *Special Access NPRM*,¶ 18 (citing *Pricing Flexibility Order*, ¶¶ 2, 90, 144).

[36] *Special Access NPRM*,¶ 18 (citing *Pricing Flexibility Order*, ¶ 144).

[37] *Pricing Flexibility Order*, ¶ 3.

[38] *Id*. ¶¶ 80-81.

Statistical Areas ("MSAs") and had some form of pricing flexibility in 97 of the 100 largest MSAs.[39]

1. Collocation is Not a Reliable Proxy to Identify Competition Sufficient to Constrain ILECs from Misusing Market Power

Contrary to the Commission's findings, the extent of collocation in a MSA under the pricing flexibility rules is not a reliable of indicator of the level of competition in the special access market needed to deter exclusionary pricing behavior within that MSA. With respect to channel terminations, *i.e.*, loops, collocators generally use ILEC UNE or special access loops and therefore, contrary to the Commission's predictive judgment, the number of collocators does not reflect alternative sources of loops needed to constrain ILEC special access prices.

Counting collocators (which use an alternative transport provider and an ILEC's special access or UNE loops to access end users) as competitors to justify pricing flexibility for channel terminations is based on illogical reasoning. A report from two FCC economists, Uri and Zimmerman, acknowledged this defect in the current pricing flexibility triggers. They found the collocation test flawed because competition could not succeed if the collocated carrier did not have facilities covering the last mile to the customer's premises.[40] They concluded that the Commission's pricing flexibility triggers that rely on the presence of collocators, *i.e.*, carriers that use transport provided by a transport provider other than the ILEC, are not adequate measures of loop deployment by competitors.[41] In the extreme, Uri and Zimmerman explained that a price cap ILEC can be

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[39] GAO Report, at 6 & n.11(noting also that price cap carriers "have also received some level of pricing flexibility in the non-MSA areas of 14 states, and phase II flexibility for all circuit components in the non-MSA are of 1 state.").

[40] Noel D. Uri and Paul R. Zimmerman, Special Access Service and its Regulation in the United States, 6 Journal of Policy, Regulation, and Strategy for Telecommunications, 122-160, at 158 (2004).

[41] *Id*. at 158.

granted pricing flexibility for its channel termination rates in an MSA even if no collocator has deployed a single loop in the MSA.[42]

The above findings were recently confirmed by the 2009 NRRI Report that found, "Collocation activity provides a weak foundation for differentiating the competitiveness of special access markets and making regulatory decisions about deregulating those markets. Collocation seems to have little or nothing to do with competition for channel terminations."[43] The NRRI Report explained that based on its "evaluation of market concentration and pricing data," the collocation-based "proxy consistently overestimates the competitiveness of the DS-1 and DS-3 channel termination markets."[44] The NRRI emphasized that:

> Despite the FCC's sweeping conclusion in its 1999 order, there is no good reason to conclude that an MSA with many collocated wire centers will develop widespread and effective competition for channel terminations. Indeed, the converse is quite possible. A CLEC can operate successfully using a business model in which it collocates frequently in order to reduce transport costs, but still relies heavily on ILEC-supplied DS-1 and DS-3 channel terminations. Indeed, a CLEC can own many collocations and no channel terminations.[45]

The NRRI study accordingly concluded that "the FCC's policy of using collocation activity as a proxy for competition provides a weak foundation for decisions to grant pricing flexibility for channel termination markets."[46]

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[42] *Id*.

[43] NRRI Report, at 84.

[44] *Id*. at 81.

[45] *Id*. at 91 (footnote omitted).

[46] *Id*. at 81. The fact that a collocator utilizes 251(c)(3) UNE loops to serve a customer does not provide alternative support for applying the collocation trigger as a proxy for competitive facilities-based loops. As discussed in Section I.(1)B.1.g.(i) below, UNEs loops are still owned and controlled by the incumbent. In addition, UNE loops only serve as a disciplining force on BOC special access pricing when these loop facilities are available; however, UNE loops are not available to all special access customers and there are certain markets where UNEs are not available at all or only in certain wire centers. And even in markets where UNEs are available to

Nor is the pricing flexibility collocation trigger an accurate proxy for transport. Since the pricing flexibility rules were adopted, a large number of competitive carriers with collocations have vacated their collocation space as the result of bankruptcy or other business reasons and therefore, collocation is not a *per se* sunk investment as the Commission originally thought. Moreover, the fact that a collocator may have alternative transport available in two wire centers does not necessarily mean that a competitive alternative route exists between the two ILEC wire centers, as the transport in each of the wire centers may be heading in different directions.

Nor does the collocation transport trigger demonstrate sufficient competition needed to constrain prices as it only requires that "at least one collocator use competitive transport facilities" "provided by a transport provider other than the incumbent LEC." In the *TRRO*, the Commission acknowledged this point and stated, "In the absence of other indicia that competitive entry is feasible, the presence of one fiber-based collocator constitutes insufficient evidence of competitors' non-impairment."[47] Collocators also do not necessarily deploy their own interoffice transport facilities and may simply obtain transport services from a competitive provider. Moreover, if a single competitive provider has transport facilities between two offices, the fact that it provides such transport to another CLEC does not mean that that there are two competitive sources of supply in the market for transport between those two offices.

The NRRI Report also rejected the collocation trigger as a valid proxy for transport. It found that "as to transport, the evidence is more ambiguous, but it is clear at least that DS-1 transport remains largely uncompetitive." It concluded that "for both channel terminations and

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certain customers, UNE loops are limited to 10 DS-1s or 1 DS-3 per building and are not available for the exclusive provision of mobile wireless or interexchange services.

[47] *TRRO*, ¶ 121.

transport, the FCC has failed to take any steps to measure directly the actual relationships between collocation and competition."[48]

2. The MSA is an Inappropriate Geographic Area in which to Grant Pricing Flexibility

Apart from the shortcomings of the collocation-based trigger itself, the MSA is an inappropriate geographic area in which to grant pricing flexibility. In conducting a competitive analysis, the relevant geographic market is an "area in which all customers in that area will likely face the same competitive alternatives for a product."[49] An MSA is far too large an area to grant pricing flexibility because within an MSA, competitive conditions vary widely.[50] Thus, for example, competition in one part of an MSA will not constrain ILEC special access pricing in another geographic area within the same MSA.[51]

As the Commission recognized in the 1999 *Pricing Flexibility Order*, competition does not occur uniformly in an MSA, *i.e.*, there may be no competitive alternatives for special access service from some wire centers in an MSA otherwise eligible for Phase II pricing flexibility. As explained above, price increases that BOCs have been able to implement (because of the absence of competitive alternatives) has not, however, been confined either to "some parts of an MSA" or

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[48] NRRI Report, at 84.

[49] *Applications of Ameritech Corp. and SBC Communications Inc. for Consent to Transfer Control*, WC Docket No. 98-141, Memorandum Opinion and Order, 14 FCC Rcd 14712, ¶ 69 n.147 (1999) (citation omitted); *see also Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 12 FCC Rcd 15756, 28 (1997) (explaining that the FCC determines the relevant geographic market by considering whether, if all carriers raised their prices in a specific area, a customer would be unable to find the same service in another area at a lower price).

[50] *See, e.g., TRRO*, ¶ 155; *see also* Reply Comments of WorldCom, Inc., RM-10593, at 9-10 (filed Jan. 23, 2003).

[51] Sprint 8/8/07 Comments, Mitchel Declaration, ¶¶ 27-28.

to some customers as the Commission contemplated. Rather, price increases have occurred throughout the MSA qualifying for Phase II pricing flexibility. Indeed, as discussed *supra*, the ability of BOCs to impose terms and conditions that requires a customer to forego use of a competitive carrier within the MSA has allowed BOCs to marginalize any competitor throughout an entire MSA.

Apart from being an inappropriate geographic area in which to grant pricing flexibility, the MSA is improper because it fails to reflect the perspective of the special access customer and whether the customer can obtain competitive special access services from non-incumbent providers in certain buildings or on certain transport routes within the MSA. When analyzing competition, the Commission previously has defined a geographic market as the market "'in which the seller operates, and to which the purchaser can practicably turn for supplies.'"[52] The MSA approach fails to take these considerations into account. For instance, it does not take into account the competitive alternatives to a ILEC's channel termination that are actually available to a purchasing customer located in a specific building within a serving wire center, let alone an MSA The MSA approach improperly ignores the vantage of the purchaser and whether there are competitive alternatives available to the purchaser in a given location or on a specific transport route between two ILEC wire centers.

3. Other Shortcomings with the Pricing Flexibility Triggers.

There are a number of other reasons why the pricing flexibility triggers are not an accurate proxy for competition that is sufficient to constrain ILEC prices.

[52] *Echostar*, ¶ 117 (*citing US v. Grinnell Corp.*, 384 U.S. 563, 588-89 (1966) and *FTC v. Elders Grain, Inc.*, 868 F.2d 901 (7th Cir. 1989)).

a. The pricing flexibility triggers do not take into account the ILEC's market power or market concentration

The pricing flexibility triggers fail to take market power or market concentration into account. As the Commission has held, a dominant carrier is "'[a] carrier found by the Commission to have market power (*i.e.*, power to control prices).'"[53] "Market power" is "the ability to raise prices by restricting output," or "to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."[54] The *Dominant/Non-Dominant Order* sets out the analytical framework the Commission applies in determining "whether a carrier is dominant or non-dominant by: 1) delineating the relevant product and geographic markets for examination of market power, 2) identifying firms that are current or potential suppliers in that market, and 3) determining whether the carrier under evaluation possesses individual market power in that market."[55]

The Commission chose to rely on the pricing flexibility triggers instead of performing a market power analysis or requiring a showing of non-dominance before granting an ILEC's pricing flexibility request. It did so based on the assumption that the triggers identify "where competitors have established a significant [, irreversible and sunk] market presence, *i.e.*, that competition for a particular service within the MSA is sufficient to preclude the incumbent from

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[53] *Pricing Flexibility Order*, ¶ 53 (quoting and citing 47 C.F.R.§ 61.3(o)).

[54] *Id*. (citation and internal quotes omitted).

[55] *Pricing Flexibility Order*, ¶ 53 (citations omitted) & n.439 (explaining that "The Commission, in the *Dominant/Non-Dominant Order*, listed a number of factors that historically have been considered in determining whether a firm possesses market power, including market share, supply and demand substitutability, the cost structure, size, and resources of the firm, and control of bottleneck facilities and citing *Dominant/Non-Dominant Order*, 12 FCC Rcd at 15766).

exploiting any monopoly power over a sustained period."[56] As discussed, however, the current pricing flexibility regime fails to accomplish that result.

The NRRI Report even found that if the Commission's "assumption had proven accurate, we would expect to find HHIs in Phase II areas much lower than in Phase I areas. Indeed, we would expect the concentration in Phase II areas to approach the lower limit of the DOJ [("Department of Justice")] standards for a highly concentrated market, with 5.5 effective firms."[57] Rather, the NRRI study results for channel terminations (converted from raw HHI values into the number of effective firms in each market) were as follows:

Effective Firms for Channel Terminations[58]

	2006		2007	
	Phase I	Phase II	Phase I	Phase II
DS-1	1.16	1.23	1.20	1.25
DS-3	1.39	1.49	1.26	1.47

The NRRI Report explained that "in none of the cases does the number of effective firms approach 5.5, the minimum number of effective firms at which Justice guidelines suggest that a market is not highly concentrated."[59] Overall, the NRRI Report found that "the concentration data are inconsistent with any claim that the channel termination markets where the FCC has granted pricing flexibility are workably competitive for channel termination markets."[60]

Moreover, a market concentration/share analysis that the NRRI Report performed also demonstrated that the shortcomings of the pricing flexibility triggers. In performing its analysis,

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[56] *Pricing Flexibility Order*, ¶141. The Commission noted that determining that "an incumbent LEC cannot exploit monopoly power over a sustained period is not equivalent to finding that carrier to be non-dominant." *Id*. n372.

[57] NRRI Report, at 47.

[58] NRRI Report, at 47 & Table 5 - *Pricing flexibility and market concentration for channel terminations in 2006 and 2007.*

[59] *Id*. at 47.

[60] *Id*. at 47-48.

the NRRI explained that "While market concentration data cannot establish market power in the general case, it has unusual value for special access markets"[61] for three primary reasons: (1) "For a century, ILECs had a monopoly over telecommunications services, both in law and in fact" and "have distribution facilities at or near almost every customer location"; (2) "the law gives the FCC the obligation to ensure that the rates of telecommunications carriers are just and reasonable" and therefore "On the question of where price regulation should be relaxed or abandoned, market concentration data should be a central consideration"; and (3) "market concentration is an important indicator of how rapidly formerly monopolistic special access markets are becoming competitive."[62]

The NRRI Report examined market concentration using two different metrics, HHI and ILEC market share analyses.[63] The NRRI's HHI analysis revealed that "all four special access markets are 'highly concentrated' under the standards contained in the Merger Guidelines."[64] When looking at the four services (DS1 and DS3 channel terminations and transport), the NRRI explained that the "HHIs remain at multiples of the concentration at which the Department of Justice would find that even a minor merger would be likely to create or enhance market power or facilitate its exercise" and that "Not one of the special access markets has even 2.0 effective firms."[65] As to market shares, the NRRI study found that there is a "continuing high concentration for all four services,"[66] as shown below.

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[61] *Id*. at 44.
[62] *Id*. at 44-45.
[63] NRRI Report, at 45.
[64] *Id*.
[65] *Id*.
[66] *Id*. at 42.

Median MSA percent of total circuits purchased from ILECs[67]	2001	2006	2007
DS-1 Channel Terminations	92%	100%	99%
DS-1 Transport		100%	98%
DS-3 Channel Terminations	81%	92%	91%
DS-3 Transport		86%	67%

Thus, the fact that the triggers do not consider market concentration renders them a invalid barometer as to the nature of competition in the marketplace and the ability of competitors to prevent ILECs from engaging in exclusionary pricing behavior.[68]

b. The pricing flexibility triggers fail to recognize that the markets are not contestable

Nor do the pricing flexibility triggers recognize the limited impact of potential competition and the non-contestability of the special access market.[69] As the NRRI report found, "A landline competitor that builds fiber or copper distribution systems can seldom generate enough revenue to justify the incremental investment in new cables or new light fibers

[67] NRRI Report, at 42, *Table 3. ILEC shares in median MSA for Special Access Services, 2001, 2006, and 2007.*

[68] For this reason, any analytical approach the Commission applies in determining if the pricing flexibility rules are producing just and reasonable rates should include a market power and concentration analysis. To the extent the BOCs dispute the NRRI study on the theory that the NRRI was not successful in getting the competitive community to provide the data necessary for NRRI to conduct a more complete market power and concentration analysis, the Commission may wish to address these concerns by collecting requisite data.

[69] The contestable market theory, which is determinative of whether potential competition in a particular market is likely, suggests that a competitor with low entry and exit costs can restrain an incumbent from exercising its market power. NRRI Report, at 53. The theory of "contestable markets" is based on the premise that "a market may be served by a single firm or a dominant small number of firms, but that firm may refrain from raising prices or otherwise using its market power in order to avoid entry by competitors." *Id*. at 48 (citation omitted). A fundamental aspect of a "contestable market is the ability of a new competitor to reverse an entry decision without cost." *Id.* "A market therefore would not be contestable if a new entrant who decides to exit would face large financial losses, such as by abandoning sunk investments." *Id*. A decision to enter at will may be reduced based on "nonfinancial entry barriers, such as the incumbent's economies of scale and difficulties in gaining access to customers." *Id*.

often needed to serve a new customer."[70] The GAO's findings also suggested that the Commission's competitive collocation triggers may not accurately predict competition at the building level.[71] The GAO noted that a variety of factors could limit competition at the building level, including the high sunk costs of constructing local networks, the cost of local government regulations, and limited access to buildings.[72]

For example, it cost one Commenter approximately $50,000 and required nearly 12 months of effort -- largely because of permitting requirements -- to deploy a single lateral into a commercial building in San Francisco. In addition, the GAO found that "where demand for dedicated access is relatively small, such as buildings with less than three or four DS-1s of demand, it is unlikely to be economically viable for competitors to extend their networks to the end user."[73]

The pricing flexibility triggers thus fail to recognize that the special access market is not contestable. Stated differently, because the triggers fail to recognize that it is uneconomical for potential competitors to construct last mile loops, absent an evaluation of demand within each building ILEC pricing is not constrained by the possibility of potential competition.

For this reason, any analytical approach the Commission applies in determining if the pricing flexibility rules are producing just and reasonable rates should be based on "actual competition" and not "potential competition." As discussed below, in the *TRRO*, the

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[70] NRRI Report, at 54.

[71] GAO Report, at 19.

[72] *Id*. at 26.

[73] *Id*. at 13. The record fully demonstrates that building last mile laterals to buildings is a highly unlikely proposition and that there is a limited number of buildings with facilities-based competitive alternatives. *See, e.g.,* TWTC 7/9/09 Ex Parte, at 10-17 (citing significant record support); GAO Report at 20; *see also* Cbeyond Fiber Petition, Attachment B, at 7-11.

Commission adopted rules that addressed *USTA II's*[74] direction that the Commission's impairment standard must consider the potential for competitive deployment, not just actual deployment by competitors.[75] The Commission is under no such direction in this proceeding from any court. Nor could a court provide any such direction, because in this proceeding, the Commission is implementing the broad obligations of Sections 201(b) and 202(a) of the Communications Act of 1934, as amended by the Telecommunications Act of 1996 (collectively the "Act") that carriers charge just, reasonable, and non-discriminatory prices, rather than the more specific statutory impairment standard on which the *USTA II* guidance was based.

c. The pricing flexibility triggers fail to distinguish the relevant product markets.

While the pricing flexibility triggers distinguish between channel terminations and non-channel terminations, they fail to distinguish among the various channel termination and non-termination product markets. As discussed in Section I.1.B.1.(a)(i) below, the Commission makes its assessment of the appropriate product markets "from the perspective of customer demand"[76] and has recognized that "competition depends on consumers having choices between products that are fairly good substitutes for each other."[77] The triggers contain no distinctions based on the capacity of the special access circuit, *e.g.,* DS1, DS3, OC-3, OC-12, etc. and fail to recognize that these circuits are not substitutes for one another.[78] For instance, DS1 loop special access facilities and OC-12 loop special access facilities are not substitutes for each other

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[74] *United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) ("*USTA II*").

[75] *TRRO*, ¶ 93.

[76] *SBC/AT&T Merger Order*, ¶ 83 .

[77] *Echostar*, ¶ 97.

[78] OCn circuits were available when the Pricing Flexibility rules were adopted. As discussed elsewhere herein, the Commission should eliminate the forbearance it prematurely granted the BOCs and certain other ILECs for Ethernet and OCn special access services.

because the latter has far more capacity and is much more expensive. For the same reasons, DS1 transport facilities and OC-12 transport facilities are not substitutable.

d. The pricing flexibility triggers do not factor in lock-up agreements or changing circumstances

Finally, the pricing flexibility triggers fail to take lock-up agreements or changing circumstances into account. In the *Pricing Flexibility Order*, the Commission acknowledged that when ILECs obtain pricing flexibility, which enables them to offer contract tariffs to individual customers, the ILEC could engage in exclusionary pricing behavior and thereby thwart the development of competition.[79] Specifically, an incumbent can forestall the entry of potential competitors by "locking up" large customers by offering them volume and term discounts.[80] The Commission assumed, however, that since the triggers would identify the presence of facilities-based competition with significant sunk investment, it was less likely that an incumbent will try to use volume and term discounts to lock in customers.

This assumption has proven erroneous. As the NRRI Report concluded, "the combination of provisions—deep discounts, prescribed commitment levels, and large penalties—can have the effect of limiting the ability of a buyer to move circuits to competitors." Consequently, "These terms may allow ILECs unreasonably to cement their market power by limiting buyers from shifting business to competitors who may have better products, lower prices, or both." The record demonstrates that despite the sunk investment the triggers attempted

[79] *Pricing Flexibility Order*, ¶ 79.

[80] *See id.* ¶ 79; *see also id.* ¶ 125.

to identify, ILECs have wielded their market power and deterred competitive entry through such volume and term discounts.[81]

Moreover, the rules do not include a safeguard to remove pricing flexibility when circumstances change. Subsequent to the adoption of the pricing flexibility rules, a large number of competitive carriers vacated their collocation space as the result of bankruptcy or other business reasons. As of July 2006, the GAO found that the number of collocation sites had declined approximately 10% since pricing flexibility petitions were first granted.[82]

At bottom, the collocation triggers adopted in the 1999 *Pricing Flexibility Order* have numerous flaws and do not accurately measure whether competition is sufficient to constrain the BOCs' pricing and produce just and reasonable rates. As discussed above and demonstrated in the record, prices have generally not been reduced and on the contrary, have increased typically where Phase II pricing flexibility has been granted.[83] This situation, by itself and despite the other shortcomings with the triggers discussed, invalidates the triggers and MSA-wide approach for identifying where competition is sufficiently developed to supplant price cap regulation and discipline exclusionary pricing behavior.

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[81] *See, e.g.,* TWTC 7/9/09 *Ex Parte*, at 20-23; GAO Report, at 30; ATX *et al.* 6/13/07 Comments, at 35-38).

[82] GAO Report, at 24.

[83] ATX *et al.* 6/13/05 Comments, at 10-13.

B. What Analytical Framework Should the Commission Apply so that the Pricing Flexibility Rules Ensure Just and Reasonable Rates?

1. The Commission Should Apply its Traditional Market Power Analysis to Determine Where Competition Exists and Where Some Pricing Flexibility May be Warranted

The Commission should apply its traditional market power analysis to determine whether competition exists at a level sufficient to warrant some pricing flexibility for the ILEC. Because of its focus on market power in discrete markets, this analytical framework would best protect all classes of special access customers (single location, multi-location, and wholesale). This market power evaluation would be designed to assess whether conditions indicate that the ILEC retains market power and that competition alone is insufficient to induce the ILEC to provide special access at just and reasonable prices, terms and conditions. As part of this analysis, the market power evaluation would consider. Where markets that contain at least three and ideally four or more facilities based providers, the ILEC would be eligible for pricing flexibility relief from the Commission's tariffing and pricing rules. The Commission should not consider market with a lower number of competitors because the other factors of its competitive analysis are likely to show that existing suppliers are constrained in their ability to add new capacity and new entrants are unlikely to materialize.

Antitrust law and Commission precedent establish how to assess whether a carrier possesses market power. Market power is typically defined as a firm's ability to "exclude competition or control prices."[84] The assessment of whether an ILEC has market power does not rest solely on market share, although high market share can be indicative of market power.[85]

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[84] *United States v. E.I. duPont Nemours & Co.*, 351 U.S. 377, 391 (1956).

[85] *See United States v. General Dynamics*, 415 U.S. 486, 498, (1974); *see also AT&T v. FCC*, 236 F.3d 729, 736 (D.C. Cir. 2001).

Antitrust jurisprudence has, however, long established that high market share alone is enough to indicate the existence of monopoly power.[86] The courts have long held that a high market share establishes monopoly power.[87] While a high market share thus proves the existence of monopoly power, the Commission "has never viewed market share as an essential factor."[88]

Rather, as the Commission and the courts have explained, the Commission must make a broader inquiry.[89] In addition to market share, the Commission's market power analysis also considers demand and supply elasticities; that is, how consumers could substitute other services for the service in question, or how new entrants and existing competitors could add capacity to serve consumers that would seek alternatives to overpriced ILEC special access services. The Commission's market power analysis begins "by defining the relevant product markets and relevant geographic markets," "then identifying "market participants and examin[ing] market concentration," and "whether entry conditions are such that new competitors could likely enter" and defeat any attempt of the dominant carrier to impose price increases and other anti-competitive conditions.[90] In other words, the Commission's traditional market power analysis focuses on (a) "identifying the relevant product and geographic markets;" (b) "identifying the

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[86] *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966) ("holding that the existence of monopoly "power ordinarily may be inferred from the predominant share of the market" and that the fact that one participant in the market held a market share of 87% left "no doubt" that it possessed "monopoly power.").

[87] *See Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 481 (1992) (80% market share established monopoly power); *Weiss v. York Hospital*, 745 F.2d 786, 827 (3d Cir. 1984), cert. denied, 470 U.S. 1060 (1985) (market share of 80% was sufficient to establish monopoly power); *American Tobacco Co. v. United States*, 328 U.S. 781, 797 (1946) (over two-thirds of the market is a monopoly);

[88] *AT&T v. FCC*, 236 F.3d at 729.

[89] *Id*. at 737.

[90] *SBC/AT&T Merger Order*, ¶ 23.

market participants" (c) assessing the shares of market participants and the elasticities of supply and demand, and (d) determining whether the incumbent retains market power.[91]

a. The Commission should examine special access competition in discrete product and geographic markets

As discussed above, the Commission's previous special access pricing flexibility framework improperly conflates product markets, and distorts the competitive analysis by using a geographic market that has little bearing on whether customers can obtain competitive special access services from non-incumbent providers.

(i) Product markets must be defined based on sound economic criteria

The Commission, consistent with recognized principles of antitrust law, determines appropriate product markets in a market-power analysis. Under Commission precedent and consistent with antitrust principles, a "relevant product market has been defined as the smallest group of competing products for which a hypothetical monopoly provider of the products would profitably impose at least a 'small but significant and nontransitory' increase in price."[92]

The Commission makes its assessment of the appropriate product markets "from the perspective of customer demand."[93] The Commission has recognized that "competition depends on consumers having choices between products that are fairly good substitutes for each other."[94]

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[91] *Comsat Non-Dominance Order*,13 FCC Rcd at 14098 ¶ 24 (1998).

[92] *SBC/AT&T Merger Order,* n.83 (citing Horizontal Merger Guidelines, issued by the U.S. Department of Justice and the Federal Trade Commission, (Apr. 2, 1992, revised Apr. 8, 1997) §§ 1.11, 1.12 (Horizontal Merger Guidelines)); *see also Echostar,* ¶ 106.

[93] *SBC/AT&T Merger Order*, ¶ 83.

[94] *Echostar*, ¶ 97.

In markets in which such choices exist, "a single provider cannot raise its prices above a competitive level because consumers will switch to a substitute."[95]

Under these principles, a specific service or specific set of services represents a distinct product market if a hypothetical monopoly provider of those specific services could profitably sustain a non-transient, nontrivial price increase — that is, if the monopolist's profits after the price increase would exceed the monopolist's profits before the price increase.[96] If the price increase caused enough buyers to shift their purchases to a second product to render the increase unprofitable, then the second product should be considered to be part of the same product market. Moreover, absent a quantitative determination of whether two services are part of the same product market, courts have generally included products in the same market if they are "reasonably interchangeable" in their use.[97] Thus where "one product is a reasonable substitute for the other in the eyes of consumers, it is to be included in the relevant product market."[98]

As the Commission observed in the *SBC-AT&T Merger Order*, there "is significant evidence that supports separate analysis of several special access product markets."[99] The Commission found that "special access service typically consist of three different segments: (i) an entrance facility, which connects the purchasing carrier's point of presence ("POP") to the nearest wire center, carrier hotel, or similar location ("entrance facility"); (2) local transport; and

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[95] *Id*.

[96] Horizontal Merger Guidelines, at 20,572 § 1.0 (defining the relevant product market as "a product or group of products such that a hypothetical profit maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant and nontransitory' increase in price").

[97] *Brown Shoe Co. v. United States,* 370 U.S. 294, 325 (1962).

[98] *Echostar*, ¶ 106.

[99] *SBC/AT&T Merger Order*, ¶ 25.

(3) a "last mile" connection or local loop, also known as a channel termination, which runs from the transport facility to the end-user customer."[100]

To begin, the Commission should separately evaluate competition in the channel termination and the transport markets. There should be no question that these discrete products are not interchangeable. A loop connecting a customer to an ILEC central office is plainly not a substitute for transport between two ILEC central offices or vice-versa. The Commission recognized the need to evaluate these products separately in recent BOC mergers, finding that "services provided over different segments of special access (e.g., channel terminations and local transport) constitute separate relevant product markets, which may be subject to varying levels of competition."[101] In the 2009 NARUC study of special access competition, NRRI also evaluated competition in the loop and transport markets separately.[102]

Similarly, the Commission must separately evaluate product market by capacity level. The Commission's previous competitive analysis of the special access market found that "different capacity circuits are likely to constitute separate relevant product markets."[103] While the Commission elected, for administrability reasons,[104] not to evaluate distinct capacity levels as separate product markets, the record here suggests this would be fundamentally at odds with sound principles of product market analysis.

A DS1 loop, for example, is not a substitute for a DS3 loop, which has far more capacity. Similarly, because of the significant price difference, a DS3 loop cannot reasonably be

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[100] *Id*.
[101] *SBC/AT&T Merger Order*, ¶ 27.
[102] NRRI Report, at 38-48.
[103] *SBC/AT&T Merger Order*, n.90.
[104] *Id*.

considered a substitute for a DS1 loop. This same capacity level analysis should be applied in the transport market as well. In addition, because the Commenters propose that the Commission eliminate the forbearance prematurely granted the BOCs for Ethernet and OCn level special access services, the Commission's market-power analysis should separately analyze competition for OCn level services (at least OC3, OC12 and OC48 and Ethernet services). The Ethernet market should also distinguish between mid-band Ethernet and high capacity Ethernet. Finally, because competitors with access to dark fiber can reasonably deploy their own services by leasing dark fiber and deploying their own optronics, the Commission's evaluation should consider whether dark fiber is available to competitors and consider that in its competitive analysis.

(ii) Products that special access customers do not view as a substitute are not in the same product market, even if a subset of consumers do substitute them

The Commission need not consider fringe competition from so-called nascent services, such as Wi-Max, fixed wireless or satellite, nor should it consider wireline carriers with negligible market shares that are unlikely to expand outside of an isolated market niche. Although incumbents point to nascent services such as fixed wireless, satellite and broadband over powerline, the market shares of these competitors is infinitesimally small. As the DOJ has recognized, because none of these services has ever been shown to generate a "substantial share" of the market, it is likely that their presence in the market will not impede the ILEC's "ability to raise prices without losing sufficient sales."[105] In addition to their lack of substantial market presence, the lack of brand presence by these competitors and the "superior capacity and coverage" of the incumbent networks, renders these "fringe" competitors unlikely to "prevent

[105] *United States v. WorldCom, Inc. and Sprint Corp.*, Complaint, ¶ 70 (June 26, 2000).

coordinated pricing or other anticompetitive behavior" likely to occur in a highly concentrated market.[106] The 2009 NRRI Report found that new technologies, such as fixed wireless, "have had only a fringe effect and have not yet produced the kinds of pricing or concentration shifts that would indicate active competition."[107] The NRRI Report concluded "that these new technologies have had only a minimal effect on the behavior of existing special access markets."[108]

b. The Commission should adopt a building as the appropriate geographic market for analyzing competition in the loop market

The Commission has previously defined a geographic market for purposes of analyzing competition as the market "in which the seller operates, and to which the purchaser can practicably turn for supplies."[109] In previous analysis of the special access market, the Commission has determined that the "the relevant geographic market for wholesale special access services is a particular customer's location, since it would be prohibitively expensive for an enterprise customer to move its office location in order to avoid a 'small but significant and nontransitory increase in the price of special access service.'"[110]

In contrast, and as discussed above, the current framework's reliance on an MSA as the geographic market has resulted in serious market distortions. To the extent there is limited competition for loops, such competition does not occur uniformly throughout an MSA. Further,

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[106] *Id.* ¶ 71.

[107] NRRI Report, at 83.

[108] NRRI Report, at 83.

[109] *Echostar*, ¶ 117 (*citing U.S. v. Grinnell Corp.*, 384 U.S. 563, 588-89 (1966) and *FTC v. Elders Grain, Inc.*, 868 F.2d 901 (7th Cir. 1989)).

[110] *SBC/AT&T Merger Order*, ¶ 28.

the specific triggers adopted by the Commission in the 1999 *Pricing Flexibility Order* do not accurately identify where competitive alternatives to loops are available.

Even where the Commission has adopted a broader geographic market, it has conceded that a building remains the relevant geographic market for loops. In the *Triennial Review Remand Order*, for example, the Commission recognized that a building-specific test would more accurately identify impairment than would a wire center approach.[111] While the Commission found in the *TRO* that analyzing the geographic market at the building-by-building level was impractical, it should be mindful that analyzing the geographic market for loops at the wire center level may introduce imperfections that need to be addressed. Specifically, the existence of competitive alternatives to serve one or more buildings in a wire center does not mean that competitive alternatives are, or could be, available to any other given building served by the same wire center. This could be for any number of reasons, including different revenue opportunities presented by the type of customer(s) in each building, proximity to the competitor's network, building access issues, and different loop construction costs.[112] Thus, the existence of at least three or ideally four facilities-based providers in one building does not demonstrate that competitive loop alternatives exist in any other given building in that wire center.[113]

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[111] *TRRO*, ¶ 155 ("a properly designed building-specific test could assess variations in impairment far more subtly that could a wire center or MSA-based approach …").

[112] *United States v. Verizon- MCI*, Civ. Action No. 05-02103, DOJ Competitive Impact Statement, at 8 (Nov. 16, 2005) ("costs of building a last mile fiber-optic connection vary substantially for each location.") ("*DOJ Comp. Impact Statement*").

[113] Indeed, if all it took to demonstrate competition through an MSA was the existence of one building with three or four facilities-based competitors, the mere existence of a single carrier hotel would render the entire MSA competitive.

As discussed below in Section g(iv), the Commission is under no obligation to consider potential competition in fashioning a competitive analysis for the special access market. Because of the harm caused to special access customers and ultimately end user consumers resulting from pricing flexibility based on a test that inaccurately identifies competition, the Commission should identify actual competitive alternatives that could constrain ILEC prices, rather than considering the theoretical possibility of competition. This is particularly appropriate for loops (*i.e.*, channel terminations), given that competitive provision of loops is so limited.[114]

Further, the same administrability issues involved in the impairment analysis do not necessarily apply here. In its UNE decisions, the Commission assumed that it would have to evaluate impairment for "700,000 commercial buildings, and perhaps as many as 3 million buildings."[115] Because the Commission is not conducting an impairment analysis here, such an assumption would not apply. Rather, the Commission would only need to evaluate the number of competitors where an ILEC sought pricing flexibility or perhaps where the request for pricing flexibility was subject to dispute. As discussed below, the Commission has a number of tools available to it for data collection that would not require an upfront review of competition in 3 million buildings.

The Commission should further recognize that the building-by-building approach proposed in these comments is not the most granular geographic market possible. Rather, there are instances where a building-by-building approach would still overstate the level of competition. Particularly in large urban markets with tall office buildings, special access customers often face barriers in terms of building access that limit competitive access to the riser

[114] *See* TWTC 7/9/09 *Ex Parte*, at 13-17; *SBC/AT&T Merger Order*, ¶ 39; NRRI Report, at 54-56 & 82; Cbeyond Fiber Petition, Attachment B at 7-11

[115] *TRRO*, ¶ 157.

cable in the building. In certain cases, building owners may own the cabling and can limit access to certain floors. Thus a fiber provider could have access to the first floor but lack access to serve a customer on the 42nd floor.

(i) In the alternative, for reasons of administrability, the Commission might aggregate the geographic market for loops to the wire center level.

The Commission has in the past recognized that loops should be analyzed on a building-by-building basis, but has had to make concessions because conducting an analysis at such a granular level would entail "steep" and "insurmountable" hurdles with regard to administrability."[116] While the Commenters believe that the Commission has the tools to apply its analysis to the channel termination market on a building-specific basis, the wire center market may represent a reasonable aggregation if the Commission determines that administrative concerns render the building specific approach infeasible.

The Commission's finding in the *TRRO* that a wire center was a suitable substitute for a building specific approach has equal force in this proceeding. Wire centers typically "cover relatively small land areas" so they share characteristics and will not have the rural-urban dichotomy that exists in most, if not all MSAs.[117] Of course, the best approach may be to gather the data recommended elsewhere herein first, and then determine on the basis of that data if any trends or indicators tend to support a particular level of aggregation, such as at the wire center level.

[116] *TRRO,* ¶ 155

[117] *TRRO,* ¶ 161.

c. The Commission should adopt a route as the appropriate geographic market for analyzing competition in the transport market

The Commission should analyze competition in the transport market on a route-by-route basis. It makes little sense to evaluate whether competition exists on a point-to-point route by examining only one end point. Yet that is what is required under the Commission's existing pricing flexibility analysis which looks solely at collocation in a single central office instead of examining whether a competitor offers service between two ILEC central offices. The Commission recognized the need for a route-by-route analysis in the *TRRO*[118] and the same logic applies here. The Commission has long identified "transport as link between two points."[119] As the Commission correctly observed "individual routes, even within the same larger geographic area, may have very different economic characteristics."[120] MSAs are an inappropriate geographic market for the special access analysis because they are prone to overbroad analysis.[121] The Commission correctly concluded that the "wide variability in market characteristics within an MSA" that usually includes both rural and urban populations, "MSA-wide conclusions would substantially over-predict the presence of actual deployment."[122]

d. The Commission should revisit the broadband forbearance relief granted on a national basis and apply the product and geographic analysis proposed above

The special access product and market analysis proposed above should also include separate and discrete product markets for the special access services covered by the forbearance

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[118] *Id.* ¶ 80.

[119] *Id.* (citing *LEC Classification Order*, 12 FCC Rcd at 15762, 15793 ¶¶ 5, 65).

[120] *TRRO*, ¶ 80.

[121] *Id.* ¶ 82.

[122] *Id.*

granted in the *AT&T Broadband Forbearance Order* and *Qwest Broadband Forbearance Order*.[123] The Commission should revisit the forbearance granted the ILECs in these decisions and its companion decisions, as well as revisit the impermissibly broad relief that Verizon obtained when its similar petition for forbearance was deemed granted in 2006.[124] Revisiting these decisions is appropriate because a more rigorous and nuanced product and market analysis should have been conducted before this forbearance relief was granted.

The Commission is not tied to these decisions and can revisit them. In fact, while the Commission's grant of forbearance for ILEC provided transmission services such as OCn level service and Ethernet was affirmed by the D.C. Circuit,[125] the Court specifically acknowledged that such decision was "not chiseled in marble." The Court explained that the Commission has the broad authority "to reassess as [it] reasonably see[s] fit based on changes in market conditions, technical capabilities, or policy approaches to regulation."[126] Further, the Court suggested doubts about the soundness of the deemed grant of Verizon's petition and the resulting exemption from all of Title II for Verizon's transmission services such as OCn level service and Ethernet. The D.C. Circuit observed that the petition seeking review of the *AT&T Broadband Forbearance Order*, "might pack more force had the FCC lifted all common-carrier regulation on the ILECs' special access lines, thereby potentially allowing ILECs to leverage their control

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[123] *See AT&T Broadband Forbearance Order; Qwest Petition for Forbearance Under 47 USC Section 160(c) from Title II and Computer Inquiry Rules with Respect to Broadband Services*, 23 FCC Rcd 12260 (2008) .

[124] *See Verizon Telephone Companies' Petition for Forbearance from Title II and Computer Inquiry Rules with Respect to their Broadband Services Is Granted by Operation of Law*, WC Docket No. 04-440, News Release (rel. Mar. 20, 2006) ("*March 20 News Release"*); *Petition of the Verizon Telephone Companies For Forbearance*, WC Docket No. 04-440 (filed Dec. 20, 2004).

[125] *Ad Hoc Telecom. Users Committee v. F.C.C.*, 572 F.3d 903 (D.C. Cir. 2009).

[126] *Id.* at 911.

over special access lines into undue control of the broadband business services market (and to presumably squeeze out competitive broadband business service providers)."[127]

Moreover, abolishing the disparities under the existing framework and implementing a new harmonious one justifies revisiting these decisions. In the *AT&T Broadband Forbearance Order,* the Commission even articulated its goal to harmonize the treatment of services between AT&T, Qwest and other ILECs on the one hand all of whose services remain subject to Title II, and Verizon's on the other hand that are apparently exempt from Title II. The Commission stated that it wanted "avoid persistent regulatory disparities between similarly-situated competitors," and "minimize the time in which they are treated differently."[128] The Commission thus promised to "issue an order addressing Verizon's forbearance petition … within 30 days."[129] Despite this statement, more than 830 days have passed and no such order has been issued by the Commission. Rather than issuing such an order, the Commission should revisit the forbearance relief granted altogether and harmonize its treatment of ILEC OCn and Ethernet services under the same analytical framework used for evaluating competition in the DS1 and DS3 markets. A number of reasons warrant doing so.

First, in many cases, especially when considering DS3 service, the services are provided over the same facilities – namely fiber-optic facilities. The same issues regarding supply elasticity and barriers to entry apply to OCn and Ethernet markets as they do to DS3 markets. DS3 services are necessarily provided over OCn level facilities in the first place, so it would be arbitrary to use a different analytical framework to gauge the level of competition for the respective services.

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[127] *Id*. at 908.

[128] *AT&T Broadband Forbearance Order*, 22 FCC Rcd at 18732, ¶ 50.

[129] *Id*.

Second, the Commission has never conducted the kind of rigorous market analysis proposed in these comments to OCn and Ethernet service, instead relying on mere platitudes that because the ILECs decided to label these services as "broadband" they were automatically immune from a traditional market power analysis. Of course, the Commission is well aware that OCn level services and Ethernet services have long been classified as common carrier transmission services and subject to the same regulatory regime as lower capacity DS1 and DS3 service and there is no rational basis for subjecting the higher capacity transmission services to a less rigorous analysis. Because demand for these higher capacity services is ever increasing throughout ILEC regions as a consequence of broadband demand, the last thing the Commission should be doing is deregulating these higher capacity services on a national basis when a more thorough market analysis reveals there are no competitive alternatives and the ILECs can extract monopoly rents with impunity.

Third, revisiting the forbearance applied to these services is fully justified because there is no sound basis for continuing to treat the higher capacity services differently than the lower capacity DS1 and DS3 services. Before the D.C. Circuit, the Commission claimed that it continued to subject the ILEC high capacity services to basic common carrier regulation because the "ILECs' control of bottleneck special access lines in certain local areas creates the potential for improper exercise of market power."[130] But this is a fallacy; *all* providers of OCn and Ethernet services are subject to these same common carrier requirements — even those non-dominant providers that lack *any* market power whatsoever. The application of the Commission's dominant carrier pricing rules are the protective measures designed to prevent an incumbent from abusing its market power. Therefore, it is critical that the Commission first

[130] *Ad Hoc*, 572 F.3d at 909.

address whether the incumbent has market power before it decides to eliminate the principal safeguard it possesses that can discipline such market power. The product and market analysis proposed in these comments is the precise approach the Commission should use in rationally determining where to regulate – and where warranted – deregulate.

Fourth, revisiting these prior forbearance decisions is appropriate because they were not well supported. The Commission prematurely deregulated ILEC high capacity transmission services based on the erroneous notion that competitors could compete on an even playing field using ILEC DS1 and DS3 special access inputs to provide Ethernet services. This decision was ill-conceived because it was based on flimsy, anecdotal record support. The decision relied on press releases from carriers. The Commission ignored sworn declarations that provided detailed economic analysis of why competitors could not compete head to head with the ILEC's Ethernet offerings by using DS1 and DS3 transmission inputs.[131] The record clearly established that CLECs incur significant extra costs to provide Ethernet using TDM special access circuits compared to a carrier providing native Ethernet for several compelling reasons.

Competitors using TDM special access circuits to provide Ethernet must pay for multiple TDM special access DS1s simply to provide 5 Mbps or 10 Mbps Ethernet services, quickly pricing themselves out of the market against the incumbent, which can offer lower priced service over its far reaching fiber network.[132] In addition, competitors using TDM special access circuits to provide Ethernet must pay for equipment twice — their own Ethernet and TDM gear that allows the TDM circuit to carry Ethernet transmissions plus the TDM equipment included with

[131] Letter from Joshua M. Bobeck, Counsel for Alpheus Communications, LLP to Marlene S. Dortch, Secretary, FCC, WC Docket No. 06-125, at 3-4 (filed Oct. 9, 2007).

[132] *Id*. at 3.

the BOC special access service.[133] Finally, competitors using TDM special access circuits to provide Ethernet have higher costs because the combined TDM and Ethernet equipment they must use is substantially more expensive than native Ethernet equipment.[134] The Commission's failure in the AT&T and Qwest orders to take this evidence into consideration utterly fails to comport with the Commission's promise to have an open, transparent and data driven regulatory process.

Finally, undoing the disparate treatment warrants revisiting the subject orders. In particular, the Commission must harmonize its treatment of the OCn, Ethernet and other related services that were covered by the AT&T and Qwest orders, with its treatment of those same services that were covered by the Verizon forbearance petition that was deemed granted.[135] Verizon takes the position that its Ethernet and OCn services are subject only to title I. The Commission, in the Qwest and AT&T orders, rightly affirmed that these services are telecommunications services subject to title II regulation as modified by the Commission's forbearance orders. The D.C. Circuit invited the Commission to harmonize the regulatory treatment, observing that there is little if any justification for the complete removal of Title II protection.[136] The Commission should accordingly rescind the forbearance granted the BOCs for OCn and Ethernet services. Instead, it should only grant regulatory relief where real local facilities based competition exists that can effectively discipline the substantial market power the

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[133] *Id*. at 3-4

[134] *Id*.

[135] *See March 20 News Release*, WC Docket 04-440 (2006)

[136] *Ad Hoc*, 572 F.3d at 908 (noting that elimination of Title II safeguards would allow "ILECs to leverage their control over special access lines into undue control of the broadband business services market (and to presumably squeeze out competitive broadband business service providers.")

BOCs still yield in providing American businesses high speed last-mile connectivity — regardless of whether the capacity provided is TDM based DS1 or DS3, or OCn or packet based Ethernet, ATM or frame relay. All of these services rely on the same last mile fiber connections that competitors are unable to economically deploy for themselves.[137]

e. The Commission should consider supply elasticity in the special access market

As noted above, market power analysis must look beyond market share to consider both supply and demand elasticities.[138] Supply elasticity "refers to the ability of suppliers in a given market to increase the quantity of service supplied in response to an increase in price."[139] The Commission examines supply elasticity to "determine the ability of alternative suppliers in a relevant market to absorb a carrier's customers if such a carrier raised the price of its service by a small but significant amount and its customers wished to change carriers in response."[140] The Commission examines two factors in assessing supply elasticity, first the "supply capacity of existing competitors" — in other words whether existing competitors "have or can relatively easily acquire significant additional capacity" — and second, "entry barriers" that indicate

[137] In any event, revisiting the forbearance decisions is necessary because the BOCs' special access price cap offerings should be technologically neutral and not limited by technology. Currently, based on the forbearance relief granted, the BOCs and certain ILECs are only obligated to offer TDM-based DS1 and DS3 services. If the Commission decides to reinitialize the BOCs' along with these other ILECs price cap rates to reflect forward-looking costs, the Commission needs to require concurrently that their obligation to provide special access be technologically neutral. In particular, the obligation should be one that utilizes evolving forward looking technology that is not limited to a specific type of electronics, such as TDM electronics. Stated differently, it would be inconsistent for the Commission to determine special access rates based on forward-looking costs, which assumes the use of forward-looking technology is available to competitive carriers, if competitive carriers are unable to obtain the benefit of all the services the noted incumbents provide using forward-looking technology.

[138] *See, e.g., United States v. General Dynamics,* 415 U.S. at 498.

[139] *Comsat Non-Dominance Order*, ¶ 78.

[140] *Id*.

whether new competitors can easily enter the market even where existing competitors lack spare capacity.[141] Where entry barriers are low, supply elasticity is high, which in turn suggests the market is competitive.

(i) The Commission must determine whether competitors have the ability to add "significant additional capacity"

Supply elasticities tend to be high if existing competitors have or can easily acquire significant additional capacity in a relatively short time period.[142] The cost structure of the facilities-based local telecommunications market is, however, marked by the pervasive fixed and sunk costs and economies of density and scale necessary to compete and serve customers in local markets. Serving local telecommunications markets requires substantial investments in infrastructure, particularly in last mile facilities to provide special access services.

Given this complex economic backdrop, BOC claims regarding their competitors' ability to add significant additional capacity in a short time period must be carefully scrutinized. The Commission should not consider generalized claims that facilities-based wireline competitors have the ability to add significant capacity rapidly. For many of the same reasons why new entry is unlikely, existing competitors are also unlikely to be able to add new capacity quickly to serve locations where they have not already deployed facilities, even in response to anti-competitive practices or pricing from the incumbent provider.

For example, one of the Commenters recently completed deployment of five fiber "on and off ramps" to serve promising agri-businesses and other previously underserved end users in more outlying areas. This effort cost the CLEC more than $500,000 per on/off ramp, with the

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[141] *Motion of AT&T to be Reclassified as a Non-Dominant Carrier*, Order,11 FCC Rcd 3271, ¶ 38 (1995).

[142] *Motion of AT&T Corp. to be Declared Non-Dominant for International* Services, Order, 11 FCC Rcd 17963, ¶ 48 (1996).

result being to reach three new wire centers after approximately 18 months of preparation (*e.g.*, obtaining numerous permits) and construction efforts. Similarly, as noted earlier in these Comments, it cost one Commenter approximately $50,000 and required nearly 12 months to deploy a single lateral into a commercial building in San Francisco. Indeed, one Commenter has found that a lateral as short as 80 feet across public rights-of-way in San Diego would require at least 3 months (if not more) of review and approval by the permitting authority before construction can even begin. Thus, "potential competition" in the form of "significant additional capacity" is unlikely to provide a meaningful constraint to BOC practices given that the BOCs know well how difficult and time-consuming it can be to deploy facilities even where a business case might otherwise be made for doing so.[143]

(ii) The Commission should evaluate competitors' ability to overcome entry barriers

The Commission examines entry barriers to determine whether a new entrant could efficiently enter the market and begin serving customers fleeing the incumbent's service, if the incumbent raised its prices above a certain threshold. Indeed, one of the fundamental reasons Commenters have an interest in this proceeding is because they know that high entry barriers preclude them and other competitors from deploying their own loops to most customers, and

[143] Building access also presents a substantial obstacle that cannot be overlooked. Where the ILEC has secured an exclusive contract with a building owner (which it has a greater ability to do where it is the only one serving the building to start), a CLEC will be unable to serve the building even if it has fiber in close proximity to that location and could otherwise justify the lateral. *See* Letter from Tamar Finn, Counsel to PAETEC Communications, Inc., to Marlene H. Dortch, Secretary, FCC, WC Dockets Nos. 07-135 and 05-25, at 2 (filed May 29. 2009). Indeed, as part of any data inquiry, facilities-based providers should be required to identify any exclusive building access agreements that they have so that the Commission can gain a better sense of how any particular carrier may have "locked up" building access -- and such an inquiry should at the very least be a prerequisite to any thought of incorporating "potential competition" into the regulatory framework. *See* Letter from Tamar Finn, Counsel to PAETEC Holdings, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 at 2 (filed July 17. 2009).

require reasonably priced access to ILEC loop and transport facilities to compete for the vast majority of customers in any given market.

For example, PAETEC recently explained that ILEC-provided access loops represent the only means of reaching premises for over 95% of the business customers it served.[144] The Commission has also found that deployment of loops is a "costly and time consuming" undertaking.[145] Further, the Commission has found that "carriers face substantial fixed and sunk costs, as well as operational barriers, when deploying loops, particularly where the capacity demanded is relatively limited."[146] Because of these high barriers, the Commission has determined that it is "unlikely that a carrier would be willing to make the significant sunk investment without some assurance that it would be able to generate revenues sufficient to recover that investment."[147]

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[144] Letter from Tamar Finn, Counsel to PAETEC Holdings, to Marlene H. Dortch, Secretary, FCC, WC Dockets Nos. 05-25 and 04-223; GN Dockets Nos. 09-47, 09-51, 09-137; RM Nos. 10593 and 11358; and CC Docket No. 01-92 (filed Dec. 6, 2009); *see also* Letter from Tamar Finn, Counsel to TelePacific Communications, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, GN Dockets Nos. 09-47, 09-51, 09-137, RM-10593, RM-11358 (filed Dec. 7, 2009) (ILEC last-mile facilities provide the only option for TelePacific to serve the vast majority of its existing customers); Comments of PAETEC Communications, Inc., WC Docket No. 05-25, RM-10593, at 5-7 (filed Aug. 8, 2007) (PAETEC purchases 98% of special access services from ILECs in pricing flexibility MSAs notwithstanding efforts to locate alternatives); Letter from Regina Keeney, Counsel to XO Communications, LLC, to Marlene H. Dortch, Secretary, FCC, GN Dockets Nos. 09-29, 09-47, 09-51; RM-11358, at Slide 6 (filed Oct. 26, 2009) (XO must rely on ILEC facilities for 96% of its last-mile access requirements); TWTC 7/9/09 *Ex Parte*, at 14 (tw telecom must rely on ILEC facilities for most connections to commercial buildings); GAO Report, at 19-20 (finding that fewer than 6% of buildings where customer demand was limited to DS-1 services had competitive alternatives for such services, and that only 15% of buildings with demand for DS-3 services had fiber-based competitors).

[145] *TRO*, ¶ 205.

[146] *SBC/AT&T Merger Order*, ¶ 39.

[147] *Id*.

Therefore, the Commission concluded that "carriers generally are unwilling to invest in deploying their own loops unless they have a long-term retail contract that will generate sufficient revenues to allow them to recover the cost of their investment,"[148] and that even "where there is adequate retail demand, the costs of constructing the loop may be sufficiently high, or there may be other operational barriers, that may deter entry."[149] Thus, "for many buildings, there is little potential for competitive entry."[150] This is consistent with DOJ evaluation of the special access market, which tends to show that entry into a building to offer special access "is a difficult, time consuming, and expensive process."[151]

The Commission further explained that its analysis of entry barriers was supported by the DOJ's competitive analysis.[152] That analysis found that "in certain buildings where "SBC and AT&T are the only firms that own or control a direct wireline connection to the building," the merger was "likely to substantially reduce competition for Local Private Lines and telecommunications services that rely on Local Private Lines to those buildings."[153] Further, the DOJ recognized the entry barriers that precluded competitors from deploying their own facilities, determining that "although other CLECs can, theoretically, build their own fiber connection to each building in response to a price increase by the merged firm, such entry is a difficult, time-consuming, and expensive."[154] The DOJ also observed that "CLECs will typically only build in

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[148] *Id*.
[149] *Id*.
[150] *Id*.
[151] *DOJ Comp. Impact Statement*, at 8.
[152] *See SBC/AT&T Merger Order*, ¶ 40.
[153] *See id.*
[154] *See id.*

to a particular building after they have secured a customer contract of sufficient size and length to justify the anticipated construction costs for that building."[155]

Similar entry barriers exist in the transport market as well. Like loops, transport deployment involves considerable sunk and fixed cost.[156] The physical deployment of fiber "represents the most significant cost" involved in deploying of transport facilities.[157] Other costs include the cost of collocation, the cost of the fiber, the cost of optronic equipment needed to activate the fiber and the cost of obtaining access to rights-of-way.[158] While there are sunk costs, in particular the sunk costs of the actual fiber deployment in the ground, carriers self-deploying transport have more flexibility to re-use transport circuits for other customers than they have with loops.[159] But the fixed costs are considerable, particularly in urban centers where fiber must be deployed underground.[160] And while the cost to deploy fiber is lower is less populated areas, the revenue opportunities are typically insufficient to justify such deployment.[161]

f. The Commission should analyze demand elasticity

Demand elasticity refers to "the willingness and ability" of ILEC "customers to switch to another … service provider or otherwise change the amount of services they purchase … in response to a change in the price or quality of … service."[162] High demand elasticity indicates that the incumbent's customers are willing and able to switch to a competitor in order to obtain a

[155] *DOJ Comp. Impact Statement*, at 8.
[156] *See TRRO*, ¶ 72.
[157] *Id.* ¶ 76.
[158] *Id.* ¶ 75.
[159] *See id.* ¶ 72.
[160] *See id.* ¶ 73
[161] *See id.*
[162] *Comsat Non-Dominance Order*, ¶ 71.

better price or better service, and that the market is subject to competition.[163] Competitors have provided the Commission with evidence that switching providers can be problematic, particularly where the incumbents lock special access customers into long term contracts with steep termination penalties, thus requiring high costs to change providers.[164] These high costs of changing make it less likely that consumers faced with anticompetitive pricing or practices would choose another competitor.[165]

g. Market share analysis

Although not indispensible to market power analysis, market share remains an important component of the Commission's market power analysis because it examines the level of concentration in a market, and "concentration in the relevant markets is one indicator" of the potential for anti-competitive conditions.[166] Market share is also important here because as discussed above the supply and demand elasticities in the special access market suggest that it is difficult for new supply to materialize and equally difficult for customers to change providers.

(i) Identifying market participants

Before determining the shares in the market the Commission must identify the participants in each market. For example, the Commission's UNE forbearance decisions have consistently focused on "facilities-based competitors."[167] There seems little reason to deviate

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[163] *See id.*

[164] *See e.g., id*. ¶ 73 (suggesting presence of large volume of long term contracts would indicate low demand elasticity.)

[165] *See* AT&T Reply Comments, WC Docket 04-36, at 43 (filed July 14, 2004).

[166] *See Echostar,* ¶ 133.

[167] *See Petitions of Verizon Telephone Companies for Forbearance Pursuant to 47 USC §160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas, Inc.,* WC Docket No. 06-172, Memorandum Opinion and Order, 22 FCC Rcd 21293, ¶ 36 (2007) (finding Verizon not subject to sufficient level of facilities based competition.) *remanded, Verizon Tel. Cos. v. FCC*, 570 F3d 294 (DC Cir 2009).

from that requirement here. While the Commission has established that the availability of UNEs imposes some price discipline on BOCs' special access services, UNEs are still owned and controlled by the incumbent. In addition, the UNEs only serve as a disciplining force on BOC special access pricing when UNEs are available. UNEs are not available to all special access customers and there are certain markets where UNEs are not available at all or only in certain wire centers. And even in markets where UNEs are available, because UNE loops are limited to 10 DS-1s or 1 DS-3 per building,[168] competitors using UNE loops remain hamstrung in providing competition to ILEC special access services. The same applies in the transport market where CLECs are limited to 10 DS1 transport circuits on a route and 12 DS3 circuits on a route.[169]

Finally, in order to compete with the favorable pricing ILECs' offer in exchange for long term commitments, competitors also need to offer long term commitments at fixed prices. Because UNEs can become unavailable on relatively short notice or prices can be changed through a cost proceeding, CLECs relying on UNEs to compete with ILEC special access services undertake significant risk that the UNE prices will not be available for the entire duration of the fixed price long term contract offered to the customer. For these reasons, competitors using UNEs to compete in a particular market should not be included in the Commission's competitive analysis.

[168] *See* 46 C.F.R.§ 51.319(a)(4)(ii) & (5)(ii).

[169] *See* 46 C.F.R.§ 51.319(e)(2)(ii)(B) & (iii)(B).

(ii) The Commission should require the presence of at least three or ideally four facilities based providers before granting pricing flexibility

The presence of a total of at least three or ideally four facilities-based providers in a particular special access market is critical to avoid the dangers of undue concentration - including both a monopoly or even a duopoly, which, for consumers and competition, is scarcely better than a monopoly. By incorporating a threshold of at least three or ideally four facilities-based competitors in a market the Commission can fix the flaws in the current special access pricing flexibility regime which has led to the premature deregulation of ILEC special access services in most of the markets where the Commission has awarded the ILEC pricing flexibility. As a result of the premature deregulation of special access services, the ILECs have been able to raise their rivals' costs with impunity and impede entry, eventually driving out competition to the detriment of consumers.

(iii) The proposed three to four-provider test is a reasonable measure to guard against dangers inherent in highly concentrated markets

A threshold of at least three or ideally four providers in a particular special access market does not require a perfectly competitive market nor anything remotely close to it. While a three or four provider market is still highly concentrated, it is far less concentrated than a market with two providers.

Under the horizontal merger guidelines adopted by the Antitrust Division of the DOJ and the Federal Trade Commission, even a market with three to four providers is still highly concentrated. The DOJ, in analyzing mergers, "starts from the presumption that in highly concentrated markets, consumers can be significantly harmed when the number of strong

competitors declines from four to three."[170] More importantly the DOJ asserts that "consumers can enjoy substantial *benefits* when the number of strong competitors rises from three to four."[171] The DOJ considers any market with an HHI above 1800 to be highly concentrated under the guidelines. Where the incumbent has 70% of the market and its two competitors each have 15%, the HHI would be $70^2 + 15^2 + 15^2 = 4900 + 225 + 225 = 5350$. Even where the incumbent's share of the market is reduced to 58%, the market is still concentrated. In such a market the concentration would be $58^2 + 21^2 + 21^2 = 3364 + 441 + 441 = 4246$. Under the Horizontal Merger Guidelines, this remains a highly concentrated market.

In comparison, the four provider market proposed in these comments as the baseline for the Commission's new pricing flexibility standard results in a less concentrated market. Where the ILEC possesses a 70% market share and the remaining thirty percent is allocated among three other firms, each with ten percent the HHI equals ($70^2 + 10^2 + 10^2 + 10^2 = 4900 + 100 + 100 + 100 = 5200$. While the reduction in the HHI (as compared with a market in which market share is divided 70/15/15) is only 150 points, the Merger Guidelines consider an increase of fifty points as raising "significant competitive concerns,"[172] and an increase of 100 points or more as "likely to create or enhance market power or facilitate its exercise."[173] In a hypothetical four provider market where the incumbent's share is reduced to 58% there is a similar reduction in the concentration of the market. In such a market the concentration would be $58^2 + 14^2 + 14^2 + 14^2 = 3364 + 196 + 196 + 196 = 3952$ or almost a three hundred point reduction in the HHI from a more concentrated three provider market that is divided 58/21/21.

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[170] DOJ 1/4/09 *Ex Parte*, GN Doc. No. 09-51, at 15.

[171] *Id*.

[172] Horizontal Merger Guidelines , § 1.51.

[173] *Id*.

Admittedly, these are extreme hypotheticals (in the real world, the competitors are unlikely to have exactly the same market shares), but even if the ILEC share were reduced to 50% in these examples, the market would still have an HHI well above the threshold of a highly concentrated market.[174] And as the NRRI report reveals, the market concentration in existing special access markets is currently far higher, with DS1 HHI in the 8000 and above range during the period between 2001-2007 and the DS3 HHI range in the neighborhood of 6-7000 over the same period.[175] And while the HHI is designed to address undue concentration that relates to a merger analysis, the "Merger Guidelines show that HHI can be used to evaluate a market's overall competitiveness."[176]

The goal of the proposed market share analysis is not to identify a perfectly competitive market. It is designed instead to identify markets that are competitive enough that regulation of rates, terms, and conditions is no longer necessary to protect consumers against the harm of unchecked market power. This is especially critical in markets where customers are unable to easily change providers and suppliers are unable to easily add new capacity. The analysis proposed in these Comments provides far more comfort that enduring competition has firmly taken root and that granting pricing flexibility — and the competition reliant on regulated access to the ILEC's legacy infrastructure — will not harm consumers.[177]

Further, independent analysis confirms that in markets in which customers have more choices from suppliers, prices are lower. In the residential broadband market, for example, in

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[174] Even at the other extreme, where each of three competitors had a 33% market share, the HHI would be 33^2 x 3 = 3267, which is still "highly concentrated."

[175] NRRI Report, at 41 (Table 2).

[176] NRRI Report, at 39 n.155.

[177] *See, e.g., TRRO*, ¶¶ 43-45; *United States Telecom Ass'n v. FCC*, 359 F.3d 554, 575 (D.C. Cir. 2004) .

markets where customers have a choice of three providers, subscribers pay 18% more than subscribers with a choice of four or more providers.[178] In markets where there are only two providers, the price differential as compared with markets where there is a choice of four providers increases to 33%.[179] This is consistent with the development of additional competition in the MVPD market as incumbent cable operators have been subject to increased competition from ILECs and direct broadcast satellite providers,[180] as well as in the mobile wireless market once the Commission licensed personal communications systems to compete with the cellular duopoly.[181]

In the event that the Commission opts to forego a building-by-building application of this framework, as discussed above, it could instead analyze competition at the wire center level and grant pricing flexibility when a significant percentage of the buildings in a market had three or ideally four providers (including the ILEC). Commenters suggest that the data to be gathered from providers as recommended elsewhere herein may assist the Commission in determining whether and to what degree such geographic aggregation is appropriate and the appropriate percentage of buildings for such a determination.

(iv) The Commission may consider potential competition although there is no statutory compulsion to do so

In its impairment analysis under Section 251 of the Act, as interpreted by the D.C. Circuit, the Commission is obligated to consider, even in the absence of actual competition in a

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[178] Pew Internet & American Life Project Home, Broadband Adoption 2009, at 27 (2009), *available at* http://www.pewinternet.org/Reports/2009/10-Home-Broadband-Adoption-2009.aspx.

[179] *Id*.

[180] *See* DOJ 1/4/09 *Ex Parte,* GN Doc. No. 09-51, at 15-16.

[181] *Id*. at 17-19.

particular market, whether conditions for competitive entry exist creating the potential for competition even where none currently exists. But this requirement does not apply in the Commission's consideration of its special access regulatory framework. The D.C. Circuit's requirement that the Commission consider potential competition derives from the statutory mandate of unbundled access unique to the Section 251 impairment criteria. No such statutory concerns exist here and it is reasonable for the Commission to forego a potential competition analysis or at least limit the circumstances under which it conducts such an analysis. The Commission has previously explained the difference between the statutory impairment analysis which is "focused solely on the likelihood of competitive facilities deployment" and its special access regulatory analysis which "focuses on special access competition generally."[182] In the event the Commission opts to use "potential competition" in its analysis, it must use have a sound factual basis for concluding that potential competition has an actual chance to take hold. The last several years have shown that the FCC has erroneously assumed away the significant cost and operational hurdles facing competitors who were suppose to be the source of the "potential competition."

2. Data collection

In order to validate the methodology proposed in these comments, the Commission should conduct a statistically significant data collection in representative price cap and pricing flexibility markets. For all products except dark fiber, the Commission should seek street address information for buildings actually connected to fiber that is owned and lit by a service provider. The Commission (as well as the DOJ) has collected evidence at this level in the BOC/IXC merger approval proceedings. Indeed, the Commission could simply require providers to submit

[182] *SBC/AT&T Merger Order*, n.90.

the data that they already presumably use to prepare their Form 477 reports today -- the "on-net" addresses that each provider must identify to be able to prepare and report on a census tract level the facilities-based deployment of broadband services. If such data were submitted, the Commission could then presumably sort that data by whatever it deems to be the relevant market (building or wire center), determine which providers had identified addresses applicable to that market, and identify the extent of competition in that market (*e.g.*, are there 3 or 4 providers serving a given building or a specified percentage of buildings within a given wire center?). Thus, the industry should already have the tools available to report this information (although it will admittedly require some level of work to ensure accuracy and standardization), and the Commission can use the data to develop and assess a more granular test for where pricing flexibility is warranted.

The data collection should be limited to **lit** buildings, however, because the analysis to determine whether the cost/time/investment for constructing laterals to existing fiber networks is not easily administrable. The Commission would have to determine the distance at which constructing a lateral is reasonably economic. Further, it would have to assess a reasonable time in which such laterals could be constructed. Because local conditions in markets vary significantly, it would be burdensome for the Commission to derive a reasonable timeline to use in its framework and such resulting timeline would be subject to significant discrepancies in markets where local governments have imposed building moratoria that significantly impede deployment. The same rationale applies to costs, especially in markets where local governments have imposed anti-competitive franchise fees on new entrants while collecting nothing from incumbents that deployed their infrastructure to all the potential customer buildings in the

market.[183] Finally, any formula the Commission might develop would be subject to significant variance because the presence of an existing fiber network within x feet of a building does not mean the fiber is accessible at the nearest point. Fiber networks properly limit the number of splice points to minimize points of failure and maintain network performance.

Further, by relying only on lit buildings, the Commission would not have to consider the effect of building access restrictions on competition. Once a competitor has a lit building it is obvious that the provider has made arrangements for access to at least part of the building (although not necessarily all of it). If the Commission were to expand its analysis to non-lit buildings where laterals could potentially be deployed, it would also have to consider whether the building was accessible or whether the building owner had imposed conditions that as a practical matter precluded competitive access to all or part of it. Moreover, the application of the analytical framework would be subject to considerable difference depending on the market and whether the local government or state had imposed any building access regulations such as those imposed in Texas and Connecticut.[184] The Commission's analysis will be simpler and far more consistent across markets if the analytical framework only includes lit buildings where competitors have already overcome any impediments to deployment and determined that connecting their fiber networks to the building was economical.

Finally, even if it were to allow for counting of leased facilities in the competitive analysis, the Commission should not consider a provider serving a building using unbundled access to network elements as a competitor for purposes of the competitive analysis. UNEs are

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[183] Level 3 Communications, LLC, Petition for Declaratory Ruling that Certain Right-of-Way Rents Imposed by the New York State Thruway Authority Are Preempted Under Section 253, WC Docket No. 09-153 at 1 (filed July 23, 2009).

[184] *See e.g.* 16 Tex. Admin. Code § 26.129(i)(3)(B)(iii) (2003); Conn. Gen. Stat. § 16-247l(a) (2001).

not acceptable substitutes because they lack service quality guarantees, are not offered to providers with term commitments and thus can become unavailable when impairment no longer exists or of the conditions for a grant of forbearance are found to exist, thus eliminating access to UNEs. Moreover, given that Verizon now maintains that UNEs cannot be used to provide IP based services, there is a new risk that UNEs are even less of substitute for special access services. Finally, under existing law, UNEs are not available to serve all customers in all areas (e.g., wireless and interexchange carriers and end users).

3. Administrative Ease of Applying the Proposed Analytical Framework

The analytic framework proposed in these comments, including the route-by-route transport market analysis and the building-by-building analysis for the loop market, is reasonable and administrable. In evaluating the BOC/IXC mergers, the DOJ was able to collect building-by-building data from CLECs through the use of the CID process. In the Commission proceedings regarding the same mergers, AT&T and MCI (now Verizon Business) also provided such data.[185] The Commission's authority to issue data requests would enable it to collect the same data that the DOJ collected in the merger proceedings. Carriers have already compiled broadband service addresses for Form 477 reporting. The Commission could also consult with the DOJ to devise a data collection effort similar to that it used in the merger review process.

Nor would a building-specific or route specific analytical approach create undue administrative burdens. In order to obtain the requisite data, the Commission could require the ILECs to certify, with supporting evidence, that three competitive providers serve a building using facilities *they each fully and independently own, operate, and maintain* and not facilities

[185] *SBC/AT&T Merger Order*, ¶ 38.

leased from, operated by, or otherwise provisioned, maintained or controlled by other carriers.[186] Moreover, there should be a mechanism that would enable a CLEC to be provided a list of buildings for which it has been identified by each ILEC so the CLEC can assist in the verification of the building data. For transport routes between ILEC wire centers, the ILECs could also certify that the identified competitive providers "fully and independently own, operate, and maintain" the transport facilities at each end of a transport route.[187] Of course, given the disputes that have arisen in implementing the *TRRO* fiber based collocator standard, the Commission should make its directions clear that a CLEC that is itself a customer accessing another competitive carriers' fiber transport facility does not count as a second separate owner on a particular route. The Commission could then provide competitors an opportunity to challenge that certification.

This approach follows the approach the Commission adopted for copper loop retirement notices.[188] In contrast to the approach taken in the copper retirement rules, the Commission should, however, not deem any oppositions to an ILECs certification denied unless the

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[186] Counting the number of facilities-based providers at a location should not be problematic to ILECs because they have been doing similar counting at the wire center level as a result of the *TRRO*. *See TRRO*, ¶¶ 5, 66, 146; *see also* 47 C.F.R. §§ 51.319(a)(4)-(5)& (e)(3).

[187] A more detailed definition of what constitutes a facilities-based carrier should be adopted than the one adopted in the *TRRO* because the interpretation of the *TRRO's* "fiber-based collocator" definition has been debated and has been the subject of litigation before a number of federal district courts. *See Indiana Bell Telephone Company v. Hardy,* 2009 U.S. Dist. LEXIS 24785, at *5-*16 (S.D. Ind. Mar. 23, 2009) (reviewing the Indiana Regulatory Commission's interpretation of the *TRRO's* "fiber-based collocator" definition); *Ill. Bell Tel. Co. v. Box*, 2008 U.S. Dist. LEXIS 61355, at *30-*40 (N.D. Ill. Aug. 11, 2008) (reviewing the Illinois Commerce Commission's interpretation of the *TRRO's* "fiber-based collocator" definition); *XO Communications Servs., Inc. v. Ohio Bell Tel. Co.,* 2008 U.S. Dist. LEXIS 21247, at *2-*5 (S.D. Ohio Mar. 18, 2008) (reviewing the Ohio Public Utilities Commission's interpretation of the *TRRO's* "fiber-based collocator" definition); *Verizon v. Pennsylvania Public Utility Commission,* No. 2:08-cv-03436-WD (E.D. Pa. filed July 22, 2008) (reviewing the Pennsylvania Public Utility Commission's interpretation of the *TRRO's* "fiber-based collocator" definition).

[188] *TRO*, ¶ 282.

Commission rules otherwise within a certain period of time after the opposition is received. Rather, the Commission should provide that oppositions are denied by only written order of the Commission. This approach will ensure that ILECs do not by default file certifications when a building or a transport route does not have three competitive providers that use facilities they each fully and independently own, operate, and maintain to the building or on the transport route.

(2) Do The Price Cap Rules Ensure Just And Reasonable Rates?

The Commission's price cap rules do not ensure the just and reasonable rates that Section 201(b) of the Act requires. When the price cap regime was implemented, the Commission made clear that observed returns remain the litmus test for determining whether the specific price cap rules are working to protect consumers from unjust and unreasonable rates, stating that a "price cap approach cannot free carriers to earn excessive [supracompetitive] profits in light of their costs."[189] It further emphasized that its price cap regime would include "ongoing monitoring" and that a future "comprehensive review" of the price cap mechanism would "focus prominently on the carrier costs and profits."[190]

As demonstrated below, price cap rates are not just and reasonable because, among other things: (a) they do not reflect cost decreases resulting from increased demand or efficiencies in providing special access services; (b) the bloated ARMIS rates-of-return the BOCs are enjoying demonstrates that the rates are excessive; (c) rates far exceed forward-looking cost-based UNE rates, rates offered by competitors, and rate-of-return NECA rates; and (d) the basket structure used to set price cap rates permit price increases in non-competitive areas and decreases in

[189] *Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking*, 4 FCC Rcd 2873, ¶ 885 (1989).

[190] *Id*.

competitive areas. To achieve just and reasonable price cap rates, the Commission should reinitialize rates and reform the current price cap rules as recommended below.

A. The Price Cap Rates Do Not Reflect Cost Reductions Resulting from Increased Demand and Efficiencies in Providing Special Access Services

Price cap rates are not at just and reasonable levels because they were set nearly 20 years ago and likely do not reflect all the cost reductions associated with increased demand and efficiencies in productivity. The price cap rates were originally set at levels based on the rates that existed when price caps were instituted in 1991.[191] These initial price cap rates were a product of "rate-of-return" regulation, under which incumbent LECs calculated their access rates using projected costs and projected demand for access services.[192] Over time, the demand for special access services has, however, increased dramatically, going from 5,725,345 lines in 1991 to 250,621,476 lines in 2006.[193] As a result, "the BOCs have realized special access scale economies throughout the entire period of price cap regulation, including before and after the CALLS plan and pricing flexibility were implemented."[194] The fact that "special access line demand increased at a significantly higher rate than did operating expenses and investment throughout these periods," in itself suggests "that BOCs realized scale economies in both periods."[195] While the CALLS plan was designed to "reduce special access rates over a period

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[191] *See Special Access NPRM*, ¶¶ 3 & 10-11.

[192] *Id.* ¶¶ 10-11. Since 1981, the Commission has permitted certain smaller incumbent LECs to base their access rates on historic, rather than projected, cost and demand. *See* 47 C.F.R. § 61.39.

[193] *See* Statistics of Communications Common Carriers 2005/2006 edition at Table 4.10, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-282813A1.pdf.

[194] *Special Access NPRM*, ¶ 29.

[195] *Id.*

of time,"[196] the astronomical rate-of-return evidence suggests the rates have not been sufficiently reduced to capture all the economies the BOCs have realized and therefore the special access rates are unreasonable.

Price cap rates are also unreasonable because the current price cap regime does not have an X-factor that requires price cap ILECs to reduce prices annually on a going-forward basis to reflect lower costs in provisioning special access services based on productivity gains. By way of background, the Commission's price cap scheme allows prices to "increase by a measure of inflation minus a productivity offset, or X-factor."[197] In the Commission's price cap formula, "the X-factor represents the amount by which LECs can be expected to outperform economy-wide productivity gains."[198] Without an X-factor, future customers will not share in the benefits of improvements in efficiency in the form of lower prices.

Under the *CALLS Order*, the Commission morphed the special access X-factor into a negotiated non-productivity-based transitional mechanism that lowered special access rates for a specified period of time.[199] The Commission emphasized that "[d]uring the five-year term of the CALLS Proposal, the X-factor as adopted herein *will not be a productivity factor* as it has been in past price cap formulas. Instead, the X-factor is now a transitional mechanism …to lower rates for a specified time period for special access."[200] The special access X-factor was set at 3.0 percent in 2000, 6.5 percent for the next three years, and equal to the Gross Domestic Product Price Index ("GDP-PI") thereafter, essentially freezing the special access price cap index ("PCI")

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[196] *CALLS Order*, ¶ 140.
[197] *Id*. ¶ 135.
[198] *Id*.
[199] *CALLS Order*, ¶ 140.
[200] *Id*. ¶ 160 (emphasis added).

(after accounting for exogenous cost adjustments).[201] Therefore, at the present time, all the alleged efficiency gains that certain BOCs touted to the Commission as benefits of their various mergers produce no additional benefit for special access customers who purchase special access circuits at price cap rates.[202] Under the current price cap plan, BOCs are the only beneficiaries of the productivity gains they experienced after the *CALLS Order* because the X-factor was never increased to reflect these additional efficiencies. Thus, the price cap rates fail to reflect fully the higher than average growth in LEC productivity that has resulted in reductions in telephone prices, relative to inflation.[203]

This remains the case. Data from the Bureau of Labor Statistics shows that for the period from 1996 through 2007, overall U.S. nonfarm business productivity growth averaged 2.7% per year,[204] while the wired telecommunications sector exceeded that by a considerable margin – growing an average of 4.19%.[205] In addition, the two X-factor studies by Economics and Technology, Inc., and filed in this proceeding by the Ad Hoc Telecommunications Users

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[201] *Id*. ¶ 149. The inflation adjustment and the X-factor canceled each other out.

[202] For further discussion, *see* ATX *et al.* 8/8/07 Comments, at 19-20.

[203] If it did, an X-factor productivity offset would need to be included in the price cap formula, to ensure that rates continue to decline relative to the measure of inflation, GNP-PI. *See LEC Price Cap Order*, ¶ 75.

[204] *See* United States Department of Labor, Bureau of Labor Statistics, Major Sector Productivity and Costs Index, Nonfarm Bus. Output per hour of all persons % chg qtr ago - PRS85006092 *available at* http://data.bls.gov/cgi-bin/surveymost. To arrive at this figure, the average percentage of the reported year-to-year index growth was calculated over the years 1996 through 2007.

[205] *See* United States Department of Labor, Bureau of Labor Statistics, Industry Labor Productivity and Costs Data Tables: Annual Rates of Change, Wired Telecommunications Carriers, *available at* ftp://ftp.bls.gov/pub/special.requests/opt/dipts/ipr.airt.txt. To arrive at this figure, the average percentage of the reported year-to-year index growth was calculated over the years 1996 through 2007.

Committee, demonstrate that an X factor in the range of 10-11 percent[206] should have applied retroactively back to 2004, when the Commission, under the CALLS Plan, set X-factor equal to GDP-PI and essentially froze the special access PCIs in 2004. Moreover, the 2007 study submitted by Sprint, which updates the 2005 ETI study, shows that the BOCs' interstate special access productivity continues to outpace productivity gains in the economy as a whole and supports an X-factor of 16.95 percent.[207] Because a "productivity-based" X-factor was removed from the current price cap formula in accordance with the CALLS Order, price cap rates are not reasonable, as they should have declined in absolute dollar terms.[208]

Moreover, the fact that the BOCs are enjoying tremendous efficiency gains (which are likely, in part, spurring the excessive earnings discussed below) and are not sharing all the gains or excessive earnings with the ratepayers is yet another reason why the price cap rates are unreasonable. In the *1997 Price Cap Review Order*, the Commission eliminated the sharing requirements, finding that sharing severely blunts the incentives of price cap regulation by reducing the rewards for ILEC efficiency gains.[209] It further found that eliminating sharing requirements abolished "a major vestige of rate-of-return regulation that had created incentives to shift costs between services to evade sharing in the interstate jurisdiction."[210] Contrary to the

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[206] Ad Hoc 7/29/05 Reply Comments, at 19-23 and Reply Declaration of Susan Gately, at 4-8.

[207] Sprint 8/8/07 Comments, at Exhibit 2.

[208] *See LEC Price Cap Order*, ¶ 75. Because LEC productivity continues to outpace that of the economy as a whole and because the X-factor has been set at the inflation rate, BOC customers see none of the benefits of productivity gains, which would continue to accrue to the BOCs as monopoly rents. *See, e.g.* ATX *et al* 6/13/05 Comments at 24-26; T-Mobile 6/13/05 Comments at 21-22; Nextel 6/13/05 Comments, WC Docket No. 05-25, at 18-20 (filed June 13, 2005); Sprint 6/13/05 Comments, at 12-13.

[209] *1997 Price Cap Review Order*, ¶ 148.

[210] *Id*.

tentative conclusion in the *NPRM*,[211] ILECs' failure to share earnings with ratepayers, similar to its previous requirements, has resulted in unreasonable price cap rates.[212]

B. The Grossly Excessive ARMIS Rates-of-Return the BOCs are Enjoying Demonstrates that the Price Cap Rates are Unreasonable

The United States Supreme Court and lower courts have consistently held that where "returns have greatly exceeded a fair percentage of return upon a fair base, it follows as a matter of law that the rates charged . . ., instead of being 'just and reasonable' …[are] excessive."[213] The extraordinarily high ARMIS rates-of-return the BOCs have earned year-after-year on their special access services show that price cap rates are not reasonable. While the BOCs assert that ARMIS rate-of-return data is flawed and unreliable, and should not be used for ratemaking purposes, the BOCs' criticisms can be rejected readily, as the record demonstrates.[214]

For example, the 2009 NRRI study — after adjusting the BOCs' earnings to address the BOCs' claim that the Commission's separation freeze renders ARMIS rates-of-return unreliable – found that the BOCs have "raised prices above average cost" and that their higher earnings are evidence that they have market power and have made substantial and sustained price increases

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[211] *Special Access NPRM*, ¶ 44.

[212] *Id*. ¶¶ 41-42 (citing *LEC Price Cap Order*, ¶¶ 122-26; *1995 Price Cap Review Order*, 10 FCC Rcd at 8970-71, ¶¶ 19-20).

[213] *Potomac Elec. Power Co. v. Public Utils. Comm'n of the District of Columbia*, 158 F.2d 521, 523 (D.C. Cir. 1947) (citing and quoting *Dayton-Goose Creek Co. v. United States*, 263 U.S. 456, 483 (1924) ("If the profit is fair, the sum of the rates is so. If the profit is excessive, the sum of the rates is so")).

[214] *See e.g.*, ATX *et al.* 7/29/05 Reply Comments, at 10-14; 360 *et al.* 8/15/07 Comments, at 14-20; Ad Hoc 8/8/07 Comments, Appendix 1: ETI - Special Access Overpricing and the US Economy, at 16-18 and A-3 through A-10; Ad Hoc 8/8/07 Comments, Declaration of Susan Gately, ¶ 6; ETI Report, at 29-31.

associated with their special access services based on the use of that market power.[215] Given this, price cap rates are unreasonably high.

Although they argue that ARMIS rates-of-return are invalid as the result of the Commission's 2001 separations freeze (which argument has no merit), the BOCs fail to address the fact that the "overall (non-compounded) BOC special access accounting rates-of-return were 28 percent in 2000."[216]. Stated differently, the BOCs' rate-of-return in 2000 (before any separations freeze) was approximately 150% *more* than the Commission's prescribed 11.25 percent rate-of-return "benchmark for determining whether price cap LECs' special access rates are just and reasonable."[217] Thus, excessive and trending upward ARMIS rates-of-return cannot be blamed on the Commission's 2001 separations freeze.

Moreover, the 11.25 percent rate-of-return is outdated and should actually be in the range of eight percent[218] making the BOCs' earnings and prices even more excessive.[219] As emphasized in earlier comments, the Commission must recognize that where there is smoke there is fire and in this case, "plumes of excessive earnings have been ignited and fueled by the BOCs excessive and unreasonable special access rates."[220]

If anything, the BOCs' average ARMIS rates-of-return are likely significantly understated, as ETI has shown, because the BOCs included capital expenditures made for the purpose of offering unregulated broadband and video services, such as Verizon's FiOS and

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[215] NRRI Report, at 71.

[216] *Special Access NPRM*, ¶ 28.

[217] *Id*. ¶ 60.

[218] *See* ATX *et al.* 6/13/05 Comments, at 23; Ad Hoc 8/8/07 Comments at 24-25; ETI Report at 7; *see also* Cbeyond Fiber Petition, Attachment B, at 3 n.3.

[219] *See also* Ad Hoc 6/13/05 Comments, at 41-42.

[220] ATX *et al.* 7/29/05 Comments, at 13.

AT&T's Project Lightspeed, within the "regulated services" category.[221] Adjusting the ARMIS reported special access category investment so that it excludes non-regulated broadband investments from the regulated services category increases the BOCs' average 2006 special access rate-of-return of 77.86% to 94.28%.[222]

Finally, although the BOCs have argued that the Commission should not rely on ARMIS rates-of-return data, they have failed to provide an evidence demonstrating what their special access rates-of-return are under some other measure that they deem more appropriate. In 2005, the Commission invited the BOCs to re-run the numbers by (1) "remov[ing] from the BOCs' interstate special access operating expenses and average investment data reported in ARMIS any expenses and investments that are not directly assignable;" and (2) "calculat[ing] the compound annual growth rates for BOC interstate special access operating expenses and average investment using these adjusted data."[223] Rather than re-calculating the ARMIS rates-of-return as the Commission requested back in 2005, the BOCs continue, more than four years later, to throw up a smoke screen by casting aspersions on the ARMIS data itself and even sought forbearance from filing such data on a prospective basis that the Commission granted.[224] The BOCs have the

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[221] Ad Hoc 8/8/07 Comments, Appendix 1: ETI-Special Access Overpricing and the US Economy, at 16-18 and Appendix 1 at A-5 through A-10.

[222] Ad Hoc 8/8/07 Comments, Appendix 1: ETI-Special Access Overpricing and the US Economy, at 18.

[223] *Special Access NPRM*, ¶ 29.

[224] In April 2008, the Commission granted AT&T's and BellSouth's (collectively, AT&T) petitions for forbearance from the Part 36 jurisdictional separations rules on a conditional basis. *See Petition of AT&T Inc. For Forbearance Under 47 USC §160 From Enforcement of Certain of the Commission's Cost Assignment Rules; Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 USC §160 From Enforcement of Certain of the Commission's Cost Assignment Rules*, WC Docket Nos. 07-21, 05-342, Memorandum Opinion and Order, 23 FCC Rcd 7302 (2008) (history omitted). In September 2008, the Commission extended the same relief to Verizon and Qwest. *See Petition of Qwest Corporation for Forbearance from Enforcement of the Commission's ARMIS and 492A Reporting Requirements Pursuant to 47 USC §160(c);*

means to recalculate their special access rates-of-return based on their challenges and criticisms about the allocations,[225] and the Public Notice rightly requires them to do so now.

For the above reasons, ARMIS data remains a reliable indicator that BOC special access prices are unreasonable and reflect the lack of competitive alternatives to the BOCs' special access services.

C. Price Cap Rates Far Exceed Forward-Looking, Cost-Based UNE Rates, Rates Offered by Competitors, and Rate-of-Return NECA rates

The fact that price cap rates for DS1 and DS3 services far exceed forward-looking cost-based UNE rates for the same services provides further evidence that price cap rates are unreasonable. In 1997, the Commission expressed hope that over time, BOCs' special access price cap rates would be at cost-based, forward-looking levels and reserved the right "to adjust rates in the future to bring them in line with forward-looking costs."[226] Unfortunately, a review of the stark differences between price cap and UNE rates, for example, demonstrates that price cap rates are far above forward-looking economic costs. The record routinely reveals the dramatic differences between the BOCs' tariffed DS1 and DS3 price cap rates, on a state-by-state basis with the rates for functionally equivalent DS1 and DS3 loop and transport UNEs set under the Commission's forward-looking, economic cost methodology.[227] In most instances, the

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Petition of Verizon for Forbearance Under 47 USC §160(c) From Enforcement of Certain of the Commission's Recordkeeping and Reporting Requirements, WC Docket Nos. 07-139, 07-273, Memorandum Opinion and Order, 23 FCC Rcd 13647, ¶ 7 (2008).

[225] *See* ATX *et al.* 7/29/05 Comments, at 12.

[226] *See Access Charge Reform Order*, ¶ 48; *see also Special Access NPRM*, ¶ 13; *CALLS Order*, ¶ 20; *Pricing Flexibility Order*, ¶ 2.

[227] *Accord, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996,* CC Docket No 96-98, First Report and Order, 11 FCC Rcd 15499, ¶ 679 (1996) (subsequent history omitted) ("we believe that our adoption of a forward-looking cost-based pricing methodology… establish[es] prices… based on costs similar to those incurred by the incumbents."); *Id*. ¶ 672.

BOCs' price cap rates far exceed economic costs despite the fact that virtually all of the available comparative UNE prices for high capacity elements such as UNE DS1 or DS3 loops were set several years ago and themselves do not properly reflect productivity gains that have since occurred

For example, evidence previously submitted in the record revealed the BOCs "discounted/Optional Pricing Plan" ("OPP") DS1 special access rates for a 10-mile circuit subject to price caps and pricing flexibility were on average much higher than comparable UNE rates, respectively.[228] In 2007 Sprint Nextel "compared 5-year term price-cap rates for DS1 and DS3 10 mile circuits with UNE rates in AT&T and Verizon territories."[229] Sprint found that "[a]cross five states (WI, TX, OR, MI, CA) AT&T's price-cap rates for DS1 circuits are from 53% to 248% greater than AT&T's comparable UNE rates."[230] It also observed that "[i]n four states (PA, NY, MA, MD) Verizon's price-cap rates for DS1 circuits are 24% to 126% greater than its comparable UNE rates."[231] It further found that "[f]or DS3 circuits (except for a single density zone in California) the price cap rates for AT&T's DS3 circuits in the five states are greater than UNE rates, exceeding them by up to 165%. In the four Verizon states the price cap rates for DS3 circuits are from 4% to 59% greater than the UNE rates."[232] Based on a 2007 sample of Qwest states (for a one-year term Zone 1 DS1 circuit with two channel terminations and 10 miles of channel mileage), Qwest's price cap rates are approximately 87% greater,

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[228] Letter from David L Lawson, Counsel for AT&T, to Marlene H. Dortch, Secretary, FCC, RM 10593 (attaching, inter alia, "Declaration of M. Joseph Stith (October 4, 2004)", ¶¶ 17-18 & attached rate comparisons (filed in RM-10593 Dec. 7, 2004); *see also* ATX *et al.* 6/13/05 Comments at 5-6.

[229] Sprint 8/8/07 Comments, Declaration of Bridger M. Mitchell ¶ 57, and Exhibit 3.

[230] *Id*.

[231] *Id*.

[232] *Id*.

respectively, than the average of UNE rates offered in Arizona, Minnesota, Colorado, Washington, and Iowa.[233]

In 2007, XO *et al.* performed a multistate comparison and found that "[w]here the surveyed carriers offer a 1-year term commitment special access contract, … the price cap rates … for DS1 channel terminations are still considerably higher than the UNE DS1 loop rates, with the price cap rates ranging from 62% higher in Arizona to 585% higher in Illinois."[234] XO *et al.* also observed that "[e]ven 3-year special access term plans do not significantly reduce the disparity between the UNE loop rates and …price cap rates … for ILEC special access channel terminations. Under available 3-year plans, price cap rates are still 52-268% higher and Phase II rates are 75-272% higher than the cost-based UNE rates."[235] In June of 2009, Sprint performed a comparison of AT&T's and Verizon's special access 5-year term price cap DS1 and DS3 rates with month-to-month DS1 and DS3 UNE rates and found the special access price cap rates were higher 100% and 41% higher, respectively.[236]

The above comparisons are reasonable because special access services are provided over the same facilities and are functionally equivalent to high capacity loop and transport UNEs and UNE prices were set at forward-looking, economic costs.[237] The United States Supreme Court found that the TELRIC forward-looking cost estimation upon which UNE rates are derived is a

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[233] *See* ATX *et al.* 8/8/07 Comments at Attachment 4.

[234] XO *et al.* 8/8/07 Comments, at 18.

[235] *Id*.

[236] Comments of Sprint Nextel Corporation, GN Docket No. 09-51, at 20 (filed Jun. 8, 2009).

[237] These are only a few of the UNE comparisons submitted in this proceeding. *See, e.g.*, T-Mobile 6/13/05 Comments, Declaration of Simon J. Wilkie, ¶ 19, Appendix 2 at 1-3; TWTC 7/9/09 *Ex Parte*, at 2.

valid and compensatory method of calculating an ILEC's true forward-looking costs.[238] Accordingly, UNE prices provide an excellent benchmark by which to assess whether the BOCs' price cap rates are near forward-looking costs.[239] Given the disparity between UNE and price cap rates, it is clear that price cap rates are excessive.[240]

To the extent there were any question as to whether special access rates grossly exceed the rates that would be offered if the market were fully competitive, the record shows that in those limited locations where some competitive alternatives to the BOCs facilities exist, the BOCs' special access rates (both price cap and pricing flexibility rates) are much higher.[241] One of the Commenters even compared ILEC channel termination rates in certain areas in California and Nevada with the rates offered by alternative facilities-based providers (where their facilities are available) and found that the ILECs' rates are approximately 42-46 percent higher than

[238] *See Verizon Communications, Inc. v. FCC,* 535 U.S. 467, 467-472 (2002).

[239] *See Access Charge Reform Order*, ¶¶ 267-68 (explaining that by February 8, 2001, it expects to have "additional regulatory tools by which to assess the reasonableness of access charges").

[240] Commenters do not provide updated comparisons of price caps rates with UNE rates because UNE rates have by and large not changed since 2005 and PCI has been frozen. Therefore, previous comparisons should, by and large, not be outdated and still be valid.

[241] *See, e.g.,* Global Crossing 8/8/07 Comments, Declaration of Janet S. Fisher, ¶ 6 & Tables 5 & 6; COMPTEL 6/13/05 Comments, Declaration of Janet S. Fisher, ¶ 9 & Tables 8-10; WILTEL 7/29/05 Comments at 5, 17-20 and Exhibit 1; *see also* TWTC 7/9/09 *Ex Parte*, at 9 (explaining that "as TWTC's charts show, the prices that AT&T charges TWTC for special access are far higher than the prices charged by competitors") & 21 (demonstrating and explaining that "TWTC's comparison of incumbent LEC DS1 and DS3 prices offered under volume and term contracts with competitive wholesalers' prices for the same services offered under *one-year, no volume contracts* shows that even the prices that incumbents charge under their volume and term contracts are almost always significantly higher than competitive wholesalers' 'off the shelf' rates.") (emphasis in original).

shorter contract term rates offered by alternative competitive providers.[242] This is another benchmark that demonstrates that rates offered by the incumbents are not reasonable.[243]

Another telling benchmark that indicates price cap rate levels are unreasonable is based on the comparison in the table below. It compares the BOCs' DS1 price cap monthly one-year term rates in various states with the rate for the same services provided out of the NECA Tariff.[244] This comparison shows that the BOC price cap rates are much higher the NECA rates.

BOC	Price Cap Rates	Percent Above NECA Rate of $218.33
Qwest	$273.85	25.43%
AT&T-CA (until 6/30/10)	$274.00	25.50%
AT&T-CA (after 6/30/10)	n/a	n/a
AT&T- MI (until 6/30/10)	$511.00	134.05%
AT&T- MI (after 6/30/10)	n/a	n/a
AT&T- TX (until 6/30/10)	$414.00	89.62%
AT&T TX (after 6/30/10)	n/a	n/a
AT&T-FL (until 6/30/10)	$403.00	84.58%
AT&T-FL (after 6/30/10)	n/a	n/a
VZ-MA	$435.82	99.62%
VZ-PA	$435.36	99.40%

[242] For transport, it is significant to note that unlike the ILECs, the alternative providers considered here do not charge distance sensitive rates for interoffice mileage.

[243] The Commission previously explained it expected that by now it would "have additional regulatory tools by which to assess the reasonableness of access charges." *Access Charge Reform Order*, ¶ 268. For instance, the Commission stressed that it may "*establish benchmarks based on prices for the interstate access services for which competition has emerged, and use prices actually charged in competitive markets to set rates for non-competitive services or markets*" *Id.*, ¶ 268 (emphasis added). The Commission explained that "[c]carriers could be required either to set their rates in accordance with benchmarks or to justify their rates using their cost studies." *Id*.

[244] Pricing reflects the total of 1 Channel Termination, 1 Channel Mileage Fixed, 10 Channel Mileage (per mile). *See* Exhibit 1 attached hereto details the composition of these rates and tariff sources.

Like the previous comparison of the BOCs' Phase II pricing flexibility rates with NECA rates provided in Section I.(1) above, this comparison is illuminating as well. As previously discussed, companies that participate in the NECA tariff are rate-of-return companies that typically serve small populations over large geographic areas and have higher costs per subscriber to deliver DS1 and other high capacity services to rural customers.[245] One would therefore expect that NECA rates should be *higher than* the BOCs price cap rates, especially since NECA members "do not enjoy the economies of scale afforded their large, non-rural counterparts that operate in urban areas and serve many thousands of access lines per square mile."[246] Moreover, since price cap "rates…[should be] no greater than they would have been under rate-of-return regulation,"[247] the fact that the BOCs' price cap rates exceed the rates offered by rate-or-return carriers, which typically offer services across thinly populated rural areas, demonstrates that the BOCs' rates are excessive and are generating unreasonable profits.

D. The Basket Structure Used to Set Rates Permits ILECs to Offset Price Increases in Non-Competitive Areas with Price Reductions in Competitive Areas

Apart from the fact that, as shown above, price cap rates are excessive on an overall basis, even if price cap rates were reasonable on average, the basket structure used to set price rates permit price increases in non-competitive areas and decreases in competitive areas. Currently, high capacity services comprise a category within the special access basket.[248] DS1

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[245] NECA Trends 2009, A report on rural telecom technology at 4, *available at* https://www.neca.org/cms400min/NECA_Templates/Studies_and_Surveys.aspx.

[246] *Id*.

[247] *Southwestern Bell v. FCC*, 153 F3d 523, at 548 (8th Cir 1998) (citing *Access Charge Reform Order*, ¶¶ 292-93).

[248] A price cap basket is a broad grouping of services. *Special Access NPRM*, ¶ 48. Currently, all special access services fall within the same basket. *LEC Price Cap Order*, ¶ 203.

and DS3 services are subcategories within the high capacity category.[249] As the record demonstrates, BOCs continue to possess market power in provision of special access service. Although there is now limited competition, there was even less competition in 1990 at the time the Commission created the special access basket comprised of high capacity and other services. Even if a single basket for all special access services may have made sense in 1990, at the present time it affords BOCs too much discretion to offset rate reductions for services that may be experiencing some competition with rate increases for less competitive services.[250] The record indicates that the BOCs, under the current price cap regime, are doing just that by offsetting rate decreases for services for which there are some competitive alternatives with rate increases for DS1 and DS3 services for which there are no competitive alternatives.[251] For

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[249] The special access basket currently contains the following categories and subcategories:

(i) Voice grade special access, WATS special access, metallic special access, and telegraph special access services;

(ii) Audio and video services;

(iii) High capacity special access, and DDS services, including the following subcategories:

(A) DS1 special access services; and

(B) DS3 special access services;

(iv) Wideband data and wideband analog services.

47 C.F.R. §61.42(e)(3).

[250] *See Special Access NPRM*, ¶ 51. For instance, "DS1 and DS3 channel termination services extending between the LEC end office and the customer premises often are subject to little or no competition." *See id.* However, "competition may not be quite so limited for DS1 and DS3 channel terminations extending between the IXC POP and the LEC serving wire center, and for DS1 and DS3 channel mileage facilities extending between the LEC end office and the LEC serving wiring center." *See id*.

[251] *See Special Access NPRM*, n.153 (citing AT&T Reply at 23-24 ("[Verizon's] channel termination portion of the total price for a single 10-mile two-ended DS-3 access circuit increased by 36%, while the transport component remained unchanged. For DS-1 circuits, Verizon increased channel terminations in some Phase II areas by as much as 24%, while increasing transport by only 4%. . . . For example, while Verizon South's DS3 entrance facility rates in Phase II areas are 13% higher than those in price capped areas, Verizon South's DS3

example, SBC-California proposed special access rate changes on April 29, 2005 in which it increased the rates for less competitive DS1 and DS3 facilities and concurrently decreased dramatically the rates for more competitive OCn facilities.[252]

Moreover, the record shows that broadband services account for a significant and growing portion of the special access revenues of some price cap LECs.[253] Yet, there is no separate category or subcategory for broadband services. Consequently, the BOCs could be offsetting decreased rates for mass market broadband or DSL service, which are subject to some competition from the cable provider, with increased rates for special access DS1 and DS3 enterprise loops in areas where there is little or no competition.

BOCs should not be permitted to justify higher DS1 and DS3 special access rates to offset their costs of deploying such mass market broadband services. While certain BOCs assert that "slashing special access rates" would deprive them of revenues needed to deploy next generation facilities,[254] Section 254(k) of the Act prohibits this type of cross subsidization.[255]

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channel termination rates in Phase II areas are *71%*; higher than in priced cap areas." (emphasis in original)), Reply Declaration of Lee L. Selwyn at 8-10).

[252] *See* SBC Communications Inc. (Pacific Bell Telephone Company, Tariff F.C.C. No. 1), Transmittal No. 223 (filed Apr. 29, 2005) (increasing the DS1 and DS3 rates (proposed revised pages 7-172, 7-179, 7-183, 7-191, 7-192) and decreasing OCn rates (proposed revised pages 20-34, 20-35, 20-40, 20-41, 20-42).

[253] *Special Access NPRM*, ¶ 52.

[254] *See* Letter from Frank S. Simone, Assistant Vice President, Federal Regulatory AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, pdf p. 6 of 8 (filed Nov. 4, 2009) (stating that "Slashing ILEC special access rates would: Deprive ILECs of revenue used to invest in next generation facilities…"); *see also* Letter from Frank S. Simone, Assistant Vice President, Federal Regulatory AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, 1-2 (filed Oct. 9, 2009) (explaining that "reducing ILEC special access rates on legacy TDM-based DS 1 and DS3 services will lead to less - not more - broadband infrastructure investment…"); Letter from Melissa Newman, Vice President Federal Relations, Qwest, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, at 14 (pdf page 15) (filed Oct. 28, 2009) (stating that "lowering prices of TDM-based services may have the unintended consequences of lowering investment in, and adoption of fiber technologies").

This exacerbates the extent to which the current price cap rates for DS1 and DS3 services are being set at levels that are unreasonable.

E. Proposed Reforms to Establish Just and Reasonable Price Cap Rates.

Commenters propose below actions the Commission should take to ensure that price cap rates are just and reasonable.

1. Reinitialize rates

As part of a program of permanent reform, the Commission should first reinitialize special access prices based on the latest demand and forward-looking cost inputs.[256] The Commission has already recognized that re-initialization may be necessary in the circumstances presented here because the current regulatory framework has failed to produce reasonable prices. In fact, it emphasized that to the extent that competition did not fully achieve the goal of moving access rates toward costs, "the Commission reserves the right to adjust rates in the future to bring them into line with forward-looking costs."[257] In reinitializing rates to reflect forward-looking costs, the Commission should revisit its forbearance decisions as discussed in Section I.(1)B.1.d.

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[255] *See* 47 U.S.C. § 254(k).

[256] As ATX *et al.* 7/29/05 Comments emphasized previously, any re-calculations would likely also reveal a relationship with demand growth and growth in expenses and investment that "suggest [] that BOCs realized scale economies…" ATX *et al.* 7/29/05 Comments, at 12 (quoting *Special Access NPRM*, ¶ 29). Because the BOCs can meet ever-increasing demand for their special access services on an incremental cost basis, the failure of the BOCs to flow through their economies of scale to the consumer and carrier market has led to excessive rates-of-return. ATX *et al.* 7/29/05 Comments, at 12. "In a competitive market, or even under the Commission's previous price cap rules, consumers would see the effects of such efficiency gains in the form of lower prices." *Id*. (quoting COMPTEL *et al.* 6/13/05 Comments, at 6). However, as the record demonstrates, the BOCs have increased prices in most cases where they have been granted pricing flexibility. *See* TWTC 7/9/09 *Ex Parte*, at 6.

[257] *Access Charge Reform Order*, ¶ 48; *see also Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps Access Charge Reform Price Cap Performance Review for Local Exchange Carriers*, CC Doc Nos. 96-262 & 94-1, Order, 17 FCC Rcd 10868, ¶ 13 (2002).

above to make clear that the BOCs' obligation to offer special access service are not limited to a specific type of electronics, such as TDM, that may be become or is already outmoded but rather are technologically neutral and employ forward-looking technology.

2. Proposed Reforms to Price Cap Rules

Once special access rates are reinitialized, the Commission should include all special access rates under a modified price cap regulatory framework. The permanent features of this regulatory framework, which are highlighted below, should include a productivity-based X-factor, revenue sharing, as well as the service baskets and categories previously proposed by ATX *et al.*.[258]

The X-Factor Should be Reapplied. Consistent with the Commission's justification of the X-factor in the *LEC Price Cap Order*, the Commission should, after it re-initializes price cap rates, re-impose a productivity X-factor offset in the price cap formula, as proposed by Sprint, to ensure that rates continue to decline relative to the measure of inflation, GNP-PI.[259] Although the Commission should, at a minimum, apply the X-factor prospectively.[260]

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[258] *See* ATX *et al.* 6/13/05 Comments, at 24-32; ATX *et al.* 7/29/05 Reply Comments, at 43-55.

[259] *LEC Price Cap Order*, ¶ 75

[260] To the extent the Commission does not reinitialize rates, it should apply the X-factor retroactively back to 2004 when the Commission, under the CALLS Plan, effectively eliminated the X-factor and froze the PCI. *See* Letter from Colleen Boothby, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, Secretary, FCC, WC Docket 05-25, 04-440, 06-125 and 06-147, at 3 and 6 (filed Oct. 9, 2007) (explaining how rates would be retroactively adjusted). Since substantial evidence demonstrates that pricing flexibility rates are unreasonable, such retroactive true-ups associated with pricing flexibility rates would be permissible because the rates were never deemed lawful under Section 204(a)(3) of the Act. *See also Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 384, 387-89 (1932) (A carrier charging a merely legal rate (in that it was properly filed) may be subject to refund liability if customers can later show that the rate was unreasonable.).

Revenue Sharing Should be Re-Imposed. The Commission should re-impose a sharing requirement and earnings sharing zones.[261] Sharing is important to correct a miscalculated X-factor. As the Commission previously acknowledged, sharing serves a number of useful purposes. First, it serves a "backstop" function - it helps ensure that any errors in the X-factor (or in reinitialization of prices in this proceeding) do not lead to unreasonably high rates.[262] Second, it serves a "flow-through" function – it helps ensure that LEC reductions in unit costs are passed through to their customers.[263] Third, it serves a "useful matching" function in a price cap plan – it encourages LECs to adopt an X-factor that most closely match[es] their internal expected rate of productivity growth.[264] Fourth, it serves an "accuracy" function – it reduces the incentive for BOCs to pad their costs as a safeguard against future investigation of rates.

The Commission's concern that sharing would increase a BOC's incentive to shift costs to the intrastate jurisdiction is unfounded.[265] The overwhelming majority of special access facilities are interstate, *i.e.*, there is more than 10 percent interstate usage over these facilities,

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[261] The Commenters do not propose any sharing thresholds but believe that the thresholds the Commission previously adopted in the *LEC Price Cap Order* are appropriate if the outdated 11.25 percent rate-of-return is utilized. Specifically, in the *LEC Price Cap Order*, the Commission established three earnings sharing zones based on specific rates-of-return. *LEC Price Cap Order*, ¶¶ 122-26. In the first zone, price cap LECs were allowed to retain all of their earnings up to the first rate-of-return ceiling, 12.25 or 13.25 percent, depending on whether the LEC elected a 3.3 or 4.3 percent productivity factor. *LEC Price Cap Order*, ¶¶ 123, 126. In the second zone, price cap LECs were allowed to retain 50 percent and return to ratepayers 50 percent of their earnings between the first ceiling and the second ceiling, 16.25 or 17.25 percent, again depending on whether the LEC elected a 3.3 or 4.3 percent productivity factor. *LEC Price Cap Order*, ¶¶ 124, 126. In the third zone, price cap LECs were required to return 100 percent of any earnings above the second ceiling. *LEC Price Cap Order*, ¶¶ 125-26. If the Commission concludes that the rate-of-return should be lowered (as it should), the above sharing thresholds should be lowered commensurately.

[262] *See 1997 Price Cap Review Order*, ¶ 147 (citations omitted).

[263] *See id.*

[264] *See id.*

[265] *Special Access NPRM*, ¶¶ 43-44.

making them subject to federal jurisdiction under the Commission's "ten percent rule."[266] Indeed, USAC presumes that all private lines -- even those connecting two locations within a single state's boundaries -- are interstate, absent carrier evidence to the contrary.[267]

Furthermore, requiring sharing is equitable in that BOCs are not entitled to excessive earnings. The BOCs cannot reasonably argue that they are being deprived of justly earned returns in the sharing zone because whatever incentive the BOCs derive from supra-competitive returns is of no use to carrier consumers if all of the financial benefits of those incentives accrue as windfalls to the BOCs. As the Commission stated in the *LEC Price Cap Order*, "this level of sharing will ensure that consumers receive their fair share of productivity gains that occur, just as they would in an industry with keener competition."[268] Without some type of limiting rules, price cap LECs will continue to earn windfall profits indefinitely, perhaps mitigated only by any applicable X-factor.

Baskets and Categories Proposed in the ATX *et al.* 6/13/05 Comments Should Be Adopted**.** For the reasons provided in 2005 and 2007 comments,[269] the Commission should modify its current basket and category structure and adopt the proposal in the ATX *et al.* 6/13/05 Comments that establishes separate baskets for DS1 and DS3 special access services and creates four categories within these baskets: (1) special access channel terminations between the LEC

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[266] *MTS and WATS Market Structure, Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, Decision and Order, 4 FCC Rcd 5660, ¶¶ 2, 6-7 (1989) (under the ten percent rule, the cost of a mixed use line is directly assigned to the interstate jurisdiction only if the line carries interstate traffic in a proportion greater than ten percent).

[267] *See Request for Review by Madison River Communications, LLC of Decision of Universal Service Administrator*, WC Docket No. 06-122, Public Notice (rel. Dec. 30, 2008).

[268] *LEC Price Cap Order*, ¶ 124.

[269] *See* ATX *et al.* 6/13/05 Comments at 28-32; ATX *et al.* 7/29/05 Reply Comments at 50-54; ATX *et al.* 8/8/07 Comments at 47-49; 360 *et al.* 8/15/07 Comments at 32-33..

end office and the customer premises (*i.e.*, loops); (2) channel mileage between LEC central offices (*i.e.*, transport); (3) special access channel terminations between the IXC POP and the LEC serving wire center (entrance facilities) and (4) any other special access product related to the basket.[270] High capacity services above the DS-3 level (*e.g.*, OCn) should be placed in a separate basket that does not include categories insofar as the Commission's determination is correct that the market for these services is competitive.[271] Also, separate baskets should be established for other retail services along with mass market broadband and DSL services. The Table below illustrates this proposal for baskets and categories.

DS1 Basket	**DS3 Basket**	**OCn Basket**	**Mass Market Broadband and DSL Services Basket**	**Other Retail Services Basket**
Categories	**Categories**			
(i) DS1 Channel Terminations	**(i) DS3 Channel Terminations**			
(ii) DS1 Channel Mileage	**(ii) DS3 Channel Mileage**			
(iii) DS1 Channel Terminations to IXC POP	**(iii) DS3 Channel Terminations to IXC POP**			
(iv) DS1 Other	**(iv) DS3 Other**			

As a general matter, implementing safeguards that prevent cost shifting from competitive services to non-competitive services is necessary to foster competition for telecommunications services. The Commission has long realized that separation of services into baskets is important. As it explained in the *LEC Price Cap Order*, "[s]ubdividing LEC services into baskets substantially curbs a carrier's pricing flexibility, as well as its ability to engage in unlawful cost shifting between the broad groups of services. Whenever a set of rates is subject to a price

[270] The 5 percent upper pricing band that currently applies to special access services and categories should also apply to the baskets and categories being proposed herein "to protect ratepayers from substantial changes in services rates." *See LEC Price Cap Order*, ¶¶ 223-24; 47 C.F.R. § 61.47(e).

[271] *See, e.g., TRO*, ¶¶ 315 & 389.

ceiling, carriers have no incentive to shift costs into the basket because the cap does not move in response to endogenous cost changes."[272]

Consistent with these Commission observations, the proposal in the ATX *et al.* 6/13/05 Comments appropriately segments the most relevant and recognized special access product markets to preclude cost shifting between such broad groups of services. In addition, the categories proposed for the DS1 and DS3 baskets, which would be subject to rate ceilings, would minimize the BOCs ability to offset rate reductions where there is competition with rate hikes between and among the various categories where there is none. Through such regulation, the proposal in the ATX *et al.* 6/13/05 Comments will protect and hopefully foster competition. For these reasons, the Commission should establish baskets and categories as proposed in those comments.[273]

(3) Do the Commission's Price Cap and Pricing Flexibility Rules Ensure that the Terms and Conditions in Special Access Tariffs and Contracts are Just and Reasonable?

The Commission's price cap and pricing-flexibility rules have not prevented the BOCs from imposing onerous and unreasonable terms and conditions on the purchase of special access services. Commenters concede that volume and term commitments may in the abstract represent a typical way of doing business in any industry -- buy in bulk or buy for longer, and thereby buy cheaper. But the possible anticompetitive impact of such arrangements is of concern when the

[272] *LEC Price Cap Order*, ¶ 200.

[273] To the extent the Commission is disinclined to establish the additional baskets that the Commenters propose (ostensibly out of concerns that the BOCs would not be able to achieve the total company productivity offset for each basket), the Commission should, at a minimum, establish separate "categories" for each of the baskets and "subcategories" for each of the proposed categories. The 5 percent upper pricing band that currently applies to special access service categories and subcategories should apply to these new categories and subcategories so that ratepayers are protected "from substantial changes in service rates." *LEC Price Cap Order*, ¶¶ 223-24; 47 C.F.R. § 61.47(e). The Commission took such an approach in *LEC Price Cap Order*, ¶ 210.

firm offering them faces little, if any, competition.[274] Indeed, the BOCs have twisted the application of volume and term commitments to turn them into "lock-ups" in many cases, and they have also loaded onto their special access purchase arrangements a number of other anticompetitive terms and conditions such as provisions that discourage or prohibit altogether the use of UNEs or that require the customer to purchase interoffice transport to get better rates for channel terminations.

ILEC "lock-up" tactics start with the manner in which their prices are structured. In particular, their standard rates are so high that every purchaser is effectively compelled to purchase in substantial volumes and/or for longer terms to be able to justify the purchase at all. Of course, if a competitor offered an alternative, such pricing tactics would be of less concern because the customer could simply take its business elsewhere -- but as discussed elsewhere herein, the ILECs hold a bottleneck in the last-mile in the vast majority of cases, leaving customers with little choice but to accept the ILECs' terms.[275] Thus, the ILECs' monopoly position enables them to drive customers toward longer-term and/or bulk purchases.[276] This monopoly position also provides leverage to the ILECs in dealing with building owners -- if the ILEC has secured an exclusive contract with a building owner (which it has a greater ability to

[274] *See* TWTC 7/9/09 *Ex Parte*, at 22 (citing Decl. of Michael D. Pelcovitz, at 7, attached to Reply Comments of WorldCom, RM-10593 (filed Jan. 23, 2003) (stating that volume and term commitments "do not have exclusionary effects in a competitive environment, because each seller is able to supply a customer's entire needs. Exclusionary or anticompetitive possibilities only arise when one firm, the incumbent monopolist, can supply each customer's entire demand.")).

[275] This can be further exacerbated by the ubiquitous reach of an ILEC -- even a CLEC might serve a particular building, if the customer in that building needs services in multiple locations, in all likelihood the ILEC will possess bottleneck control at most, if not all, of the other locations.

[276] *See* TWTC 7/9/09 *Ex Parte*, at 20 (discussing the incentives of a monopoly provider with respect to offering proportional or relative discounts "in order to induce customers to agree to exclusionary provisions").

do where it is the only one serving the building to start), a CLEC will be unable to serve the building even if it passes that location.[277]

From this position of strength, an ILEC can impose nearly any demand it wants in connection with the volume and term commitments. For example, several of the Commenters provided with comments that they recently filed in the Commission's National Broadband Plan proceeding a chart categorizing various anticompetitive terms and conditions appearing in one of AT&T's interstate access tariffs.[278] As the chart (a copy of which has been attached here as Exhibit 2) shows, AT&T imposes a requirements in its contract tariffs ranging from required conversions of UNEs to demands that a certain number or percentage of circuits be migrated from another carrier to AT&T. Verizon's contract tariffs contain similar provisions, mandating the conversion of UNEs in certain cases and also linking in at least a few contracts the purchases of more competitive transport facilities to lower rates for bottleneck channel terminations.[279]

Such terms almost certainly would be unobtainable in a competitive market in which the customer could play suppliers off of one another for better pricing without the need for further concessions. But in a market where "the only game in town" to serve all of a customer's needs is the ILEC, the customer is forced to take these additional terms and conditions if it wants to buy at any rate better than the bloated "rack" rates for special access services. Such exclusionary deals are contrary to established antitrust principles that prohibit anticompetitive bundling or

[277] Letter from Tamar Finn, Counsel for PAETEC Communications, Inc., to Marlene Dortch, Secretary, FCC WC Dockets Nos. 07-135 and 05-25, at 2 (filed May 29. 2009).

[278] Comments of TDS Metrocom, *et al.*, WC Docket No. 05-25, GN Dockets Nos. 09-47, 09-51, 09-137, RM-10593, RM-11358, at Attachment A (filed Nov. 4, 2009).

[279] A chart categorizing the provisions in Verizon's tariffs is attached hereto as Exhibit 2.

tying.[280] As an initial matter, they may reflect "monopoly leveraging," in which a firm uses monopoly power in one market to achieve a competitive advantage in another market through anticompetitive or exclusionary means.[281] Such improper leveraging not only compels customers to purchase products that they might not otherwise need or want (just to obtain better rates on the monopoly products), but it also can be used to exclude competitors who cannot offer as wide a range of products.[282]

Regardless of any rate reform, the incentives for such arrangements will persist given the ILECs' dominant position in the special access market (and in the channel termination product market in particular). The Commission should therefore adopt and strictly enforce *ex ante* proscriptions to limit specific kinds of anticompetitive terms and conditions. In particular, the Commission should prohibit any provision that requires a customer: (1) to purchase a specified quantity of other services to obtain discounts or credits on channel terminations; (2) to ensure that channel terminations represent only a limited percentage of the customer's total spend with the ILEC; (3) to satisfy any ratios that limit the amount of non-special access services a customer can purchase to receive discounts or credits; (4) to purchase products in multiple geographic markets to obtain discounts or credits; (5) to refrain from any purchases of UNEs or other specified services (or the commingling of such services with special access services); and (6) to

[280] The Commission has long considered the impact of such principles on bundling or tying of communications services and other services and products.. *See, e.g., In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, Docket No. 20828, Final Decision, 77 FCC2d 384, ¶¶ 149-61 (1980).

[281] *See, e.g., Verizon Comms., Inc. v. Trinko*, 540 U.S. 398, 415 (2004). A related concern is "full-line forcing," in which wholesalers (such as the Commenters) are compelled to accept products and services from a monopolist that they otherwise do not need or which could be self-provided or obtained from others on better terms just to gain access to products and services available only from the monopolist. *See, e.g., General Cigar Holdings, Inc. v. Altadis, S.A.*, 205 F.Supp.2d 1335, 1354 (S.D. Fla. 2002).

[282] *See, e.g., Lepage's Inc. v. 3M*, 324 F.3d 141, 155 (3rd Cir. 2003)

migrate a certain percentage of total spend or quantity of circuits from an ILEC's competitor as a condition to obtaining discounts or credits. In addition, to minimize the opportunity for new and creative ways of evading the intent of such rules, the Commission should adopt general prohibitions against any arrangements that: (a) tie an ILEC's monopoly and competitive services; and/or (b) result in any cross-subsidization through use of higher rates on services that are not subject to competition to "fund" discounts or credits applicable to competitive services.

(4) Recommended Additional Question: "How should the Commission roll out relief?"

The preceding discussion highlights the substantial task before the Commission as it considers reform of the price cap and pricing flexibility rules. The process of collecting and analyzing data to assess the current state of ILEC dominance in specific product and geographic special access markets, followed by potential adoption and then implementation of new price cap and pricing flexibility rules, will require significant effort, and the level of effort may vary from issue to issue. Therefore, in reaching its final determinations, the Commission should adopt and issue new measures on a rolling basis rather than sweeping all such final determinations into a single longer-term package of reforms. For example, if the Commission's analysis supports a new regulatory framework for channel terminations, there is no reason for the Commission to await completion of work on interoffice transport before taking action to address the channel termination issues.

In addition, interim relief is warranted because there is substantial risk that the market will change while the Commission undertakes to gather data and study it. For example, some have asserted that the rates paid by customers for special access services have not increased

under the existing pricing flexibility regime.[283] Even if this were true -- and the basis for such claims has not been made clear -- such a calculation of rates must almost certainly include the effect of contract tariffs and purchase plan commitments. But a preliminary review of ILEC tariffs (such as Pacific Bell Telephone Company Tariff F.C.C. No. 1, Section 33) indicates that a number of contract offers appear set to expire in the next several years, and some of the most useful tariff discount and credit plans have been grandfathered or withdrawn altogether.[284] Moreover, the AT&T-BellSouth merger commitments applicable to special access expire in a few months, and AT&T has "locked-in" tariff provisions that will result in rates increasing by up to nearly 25% overnight in areas where pricing flexibility has been granted.[285] Thus, absent Commission action, special access rates are certain to rise again in the near future, undermining the accuracy of any pricing data upon which the Commission might base its decisions in this proceeding.

To guard against such concerns, the Commission should "freeze" or "cap" ILEC special access rates at their current levels on an interim basis. Such a freeze would allow a customer of the ILEC to continue, until final rules are issued in this docket, to purchase interstate special access services at a rate no higher than that applicable to the customer's special access purchases as of the date the cap takes effect.[286] The freeze or cap would apply to *any and all* rates at which

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[283] *See, e.g.*, Letter from Melissa Newman, Vice President-Federal Relations, Qwest, to Marlene Dortch, Secretary, FCC, WC Docket No. 05-25, at Slide 16 (filed Oct. 28, 2009); Letter from Donna Epps, Vice President-Federal Regulatory Affairs, Verizon, to Marlene Dortch, Secretary, FCC, WC Docket No. 05-25, at Slide 6 (filed Nov. 4, 2009).

[284] For example, AT&T has grandfathered its MVP program such that those discounts are now available only on a limited renewal basis. *See, e.g.,* Ameritech Operating Cos. Tariff F.C.C. No. 2,, § 19.

[285] *See, e.g.*, Pacific Bell Tel. Co. Tariff F.C.C. No. 1, § 31.5.2.7.1.

[286] Nothing would preclude an ILEC, however, from *reducing* its rates for a customer. For example, if the ILEC were in fact subject to competition in a given area and wanted to use its

the individual customer could purchase special access services -- both standard "rack" rates and also those rates, discounts, and credits that apply under any contract tariffs or purchase plans to which the customer subscribes. Under the freeze, regardless of any limitations on renewal or expiration, customers would have the right to renew any expiring or grandfathered tariff purchase plans, contract tariffs, and any and all other purchasing arrangements until a permanent order is issued with respect to special access reform. The ILECs would be prohibited as well from withdrawing any purchase plans during the period that the interim freeze is in effect. At the same time, customers who want to continue to receive the same rates would need to comply with all of the applicable tariffed conditions (such as volume purchase commitments), and the freeze would not require an ILEC to continue to charge the same rates to a customer who no longer wanted to comply with those conditions.

This interim "freeze" or "cap" represents a reasonable means of maintaining the *status quo* and ensuring that the ILECs' ability to increase rates will not outpace the Commission's investigation. The Commission has adopted similar "freeze" measures before where faced with the prospect of circumstances changing in the face of comprehensive reform efforts.[287] But several additional forms of interim relief are also warranted in light of the current record and the state of the market. First, in addition to the freeze discussed above, the Commission should take immediate action to fix the most obvious failure of the current pricing flexibility regime -- the fact that rates in many pricing flexibility areas are *higher* than those that apply for the same

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pricing flexibility to offer a lower rate to a customer, the freeze would not prevent the ILEC from doing so. In this regard, the "freeze" operates more as a "cap."

[287] *See, e.g., Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 16 FCC Rcd 11382 (2001); *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation*, MM Docket No. 92-266, 9 FCC Rcd 1299 (1994).

services under the price cap regime. The prediction that competition would ensure just and reasonable rates in pricing flexibility areas has gone awry, with the perverse end result being that customers often pay *more* in areas that are theoretically subject to competition. The Commission should therefore immediately "roll back" any standard pricing flexibility rates that are higher than their respective price cap rate counterparts; put another way, the Commission should impose on an interim basis for the pendency of this proceeding a "secondary cap" that would ensure that the standard "rack" rates in pricing flexibility areas do not exceed price cap levels.[288] The Commission can then focus in greater detail on the issues raised earlier in these Comments with the knowledge that the harshest and most illogical aspects of the current pricing flexibility regime have been blunted for the time being.

As a second element of interim relief, the Commission should cease granting any new applications for pricing flexibility until it has adopted a new framework for such grants. The shortcomings of the current standard for such grants are obvious on the record of this proceeding, and there is little reason for the Commission to perpetuate that system even as it considers how to re-work it. Alternatively, if the Commission continues to consider and grant pricing flexibility applications by reference to the current collocation-based MSA-wide standard, it should then also prohibit the ILEC as a condition of any such grant from *increasing* the rates for interstate special access services in the subject MSA above those rates that were effective under the previously applicable price cap regime.

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[288] Of course, nothing under this secondary cap proposal would preclude an ILEC from *reducing* its price-flex rates to *below price cap levels* if competitive pressures demand such reductions. Also, to be clear, this cap should not be interpreted by an ILEC to allow it to *increase* pricing flexibility rates to price cap levels where the former rates are already lower than the latter.

As a third element of interim relief, the Commission should take up once again the option it first considered in the notice of proposed rulemaking initiating WC Docket No. 05-25 -- the interim imposition of a 5.3% productivity factor.[289] Absent application of such an X-Factor, special access prices are unreasonable *per se* because they do not reflect productivity gains that characterize the telecommunications industry, effectively allocating all the benefits of productivity gains to the ILECs and none to their customers. Indeed, if anything, a 5.3% X-factor may be too low in light of the substantial investment that many ILECs have made in last mile facilities (e.g. hybrid loops, FTTC, FTTH) in connection with broadband deployment; such investment should presumably have a proportionally greater effect on special access service efficiency than it would for other price cap services like switched access or transport.

[289] *Special Access NPRM*, ¶ 131. This was the last productivity factor adopted by the Commission before the CALLS plan.

II. CONCLUSION

The Commission should promptly grant the requested relief.

Respectfully submitted,

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